THE ENLARGEMENT OF THE EUROPEAN COMMUNITY AND ITS IMPACT ON SRI LANKA

by

Douglas Jayasekera

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THE ENLARGEMENT OF THE EUROPEAN COMMUNITY AND ITS IMPACT ON SRI LANKA

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1. INTRODUCTION

The European Community and the seven countries comprising the European Free Trade Association (EFTA) have agreed on the establishment of an European Economic Area (EEA) with effect from January 1, 1993, creating thereby a free trade area of 380 million consumers. The European Economic Area, the world's biggest free trade zone, would stretch from the Arctic to the Mediterranean, and from the Atlantic Ocean into Central Europe. Obstacles to the free flow of Goods, Services, Capital and Labour are expected to be abolished, with the exception of the sensitive agricultural sector.

It is possible that certain member countries of the EFTA, such as, Austria, Sweden, Finland, Switzerland and Norway, who are not at present members of the European Community, will seek to join it in the near future; the same could be true of the former socialist countries of East Europe.Some less developed countries too, such as Turkey, Malta and Cyprus have also indicated an interest in seeking membership in the European Community. Hence there is the likelihood of a very large trade association emerging in Europe, which could have a significant impact on trade the world over, including Sri Lanka.

In the wake of the Single Market in 1993 and the envisaged enlargement of the Community, an economic and political union is also expected to emerge. Of significance is a move for a single currency, by 1999 at the latest - a beneficial effect of which is foreseen as an increase in trade among the members of the Community, with the elimination of currency fluctuations. Whether this will be so in actual practice remains to be proved. What could prove undesirable, however, is a loss of independence in the management of monetary policy at the national level. Among other proposals towards further integration, are the establishment of a single central bank, a single foreign and defence policy, and

uniform rules and regulations for the management of labour, industry and the environment.

Those opposed to European integration have warned against the emergence of a federal Europe and an European super-state, which is in danger of threatening and ending national sovereignty. Such opposition was evidenced in Denmark, for example, where the country voted against European union.

However, the Maastricht Declaration for greater European integration and cooperation, which was adopted by the 12 states of the European community in December 1991, appears on the road to success. The ratification of the Maastricht Treaty will be followed by formal negotiations for the enlargement of the Community.

2. HISTORICAL BACKGROUND

The origin of the Single European market can be traced to the 1957 Treaty of Rome which formed the basis for the creation of the European Economic Community consisting of Belgium, Germany, France, Italy, Luxembourg and Netherlands, which were joined by UK, Ireland and Denmark in 1973, Greece in 1981 and Spain and Portugal in 1986. The EC had set itself the objective of establishing a customs union through the removal of barriers to intra-Ec trade and maintenance of a common tariff for imports from other countries. In addition the creation of a common market with free movement of factors of production was also envisaged. The Treaty of Rome sets out this objective:

> *"The community shall have as its task, by establishing a common market and progressively approximating the economic policies of member states to promote throughout the community, a harmonious development of economic activities, a continuous and balanced expansion, an increase in stability an accelerated raising of the standards of living and closer relation between the states belonging to it''.*

By 1986 customs duties and import quotas on intra-EC trade were abolished. However, the goal of the single market had not been achieved because of a number of barriers such as border restrictions, government procurement policies and differing national technical standards. Free movement of labour and capital had also been impeded by various national regulations.

To reach the goal of a single market, the EC adopted a white paper in 1985 which detailed measures for eliminating the remaining physical, technical and fiscal barriers to the free movement of goods, services, capital and labour within the community, by the end of 1992. This move was followed by the Single European Act.

3. THE SINGLE EUROPEAN MARKET

The institutional structure for completing the internal market by 1992 is provided by the Single European Act. The Act became effective in July 1987 upon ratification by all the member states. It specifies Community policies to lead up to the European Union. It includes:

- the completion of the single market;
- economic and social cohesion;
- research and technological development;
- economic and monetary union;
- social policy;
- the environment; and
- political co-operation in the field of foreign policy.

3.1 Main Objectives

The main objectives in forming the integrated market is to promote specialization, enhance competition and increase efficiency in the EC. According to a report "European Challenge 1992", commissioned by the EC in 1988, which in fact provided the rationale for the creation of a single market, the integration of the European market would add about 5% to the community GNP, create 2 million new jobs and keep consumer prices 6% lower, than in a divided market.

3.2 Moves Towards Integration

The integration process is not easy. In order to realise the enlarged market three primary measures were envisaged to be undertaken. They are:

1. the removal of physical barriers

This measure would be to abolish border controls and enable the free

physical movement of goods and services among the 12 member states. With the reduction in paper work resulting from the elimination of border controls and phytosanitary certification, increased efficiency and speed in the transportation of goods could be anticipated. Moreover, the removal of physical barriers would facilitate the free movement of labour.

2. *the removal of technical barriers*
This was to be achieved through mututal recognititon and harmonization of regulations.

3. *the removal of fiscal barriers*
This measure would open up public procurement and remove distortions arising from different tax systems.

In accordance with the Single Act, in particular, Article 8a of the Treaty, 279 measures were originally expected to be adopted by the EEC Commission and later by the Council of Ministers, with the assent of the European Parliament. These measures (directives, regulations, decisions, etc.,) after adoption by the Council of Ministers, were expected to be transposed into the legislations at the national level before the end of 1990, to achieve the objective of the completion of the Single European Market by 1.1.93. The process of completing the programme as envisaged however, is not yet over.

The number of originally-envisaged measures has now increased to 286. The increased proposals, over and above the number of 279 are known as non-white paper measures. The last proposal of the 286 measures was submitted to the Council of Ministers in April 1990, hence the Commission claims that it has already fulfilled its part of the responsibility well in advance. The position however as at April 1992 is that, of the 286 measures, 233 measures have been adopted by the Council of Ministers - 82% of the total number. The remaining 53 measures (18%) are yet to be adopted by the Council of Ministers.

The delay has been due to the preoccupation of the European Parliament with unprecedented global events - the Gulf Crisis, the changes in Eastern Europe, the collapse of the USSR, and more recently the trouble in Yugoslavia, etc., as well as to the voting

system in the Community. The voting pattern in the Council of Ministers and the European Parliament is through simple majority (SM), qualified majority (QM) and/or unanimity (U). Although substantial progress has been made towards the completion of the Single Market from 1.1.93 about 25 measures require unanimous agreement of the Member States involving vital areas such as harmonization of taxation, European company status, closing of external frontiers, etc.

However, the slow pace on the part of the national legislatures to comply with Community measures in time, will not jeopardise the completion of the Single Market at the Community level. The Community has devised an effective monitoring scheme to accelerate the implementation of the Community legislation at the national level, which according to the Commission, is showing success. In addition, at the European Council, an impetus has been provided by a strong political will by all Member countries to expedite the implementation at the national level, thus paving the way for the acceleration of the process towards the completion of the Single Market.

Some contend that "a Single Market race horse is now beginning to look like a cart horse" thus, expressing a pessimistic view that 1.1.93 cannot mark the beginning of an integrated Single market since a final agreement on harmonization of taxation has been postponed till 1996. Further, in several vital areas, unanimity has not been achieved by all Member States. The time left is under half a year. Therefore the European Single Market as envisaged will not be achieved by 1.1.93. The remaining areas will be agreed upon after the formal inception of the Single Market from 1.1.93.

4. THE EXTERNAL DIMENSIONS OF THE SINGLE MARKET: TRADE POLICY REGARDING THIRD WORLD COUNTRIES

There has been no officially documented policy statement released by the Community regarding trade policy with Third World Countries. The only direct reference is the statement that "the commercial identity of the community must be consolidated so that its trading partners will not be given the benefit of a wider market without themselves making similar concessions". The community authorities have also made the point that the creation of the single market would not mean that it would close in on itself. The EC depends on

external trade for its survival, and an integrated market with 380 million consumers would provide more opportunities to its trading partners.

4.1 Developments in Eastern Europe

A factor that will influence the Single Market Programme is the political and economic upheaval in Eastern Europe, and the USSR. Apart from their political importance, the changes can have far reaching consequences for economic co-operation in Europe. Driven by cultural affinity and geographical proximity the EC may look to expand trade and investment in Europe, and this could be at the expense of the developing countries (such as Sri Lanka). Given the relatively lower labour costs in Eastern Europe compared to those in the community, EC companies may be attracted towards setting up production facilities in these countries.

Furthermore, the massive requirements of finance and imports needed to promote economic development in Eastern Europe will result in the EC focussing its efforts both in terms of aid and commercial orientation towards meeting them, pushing the developing countries to a lower order of priority. The trade and co-operation agreements by EC with a number of other countries of Eastern Europe and its readiness to consider concluding association agreements at a later stage reflect the strong political determination to establish closer economic links. Preferential market access with relatively wide product coverage would significantly extend the scope of preferences which some of these economies have been accorded in the past, such as benefits under the GSP and outward-processing arrangements. Greater ease of market access could favour imports from countries of Eastern Europe at the expense of imports from developing countries. The potential for trade diversion could be significant if Eastern European countries receive preferential treatment which is as favourable as or more favourable than the treatment granted to imports from developing economies.

4.2 The EC Position

EC Commission President Jacques Delors was reported to have said that "as long as our partners do not resort to protectionism or dumping there is no reason for us to take the offensive in these areas. Our prosperity is linked to our openness but this openness must not mean naivety" This statement does not clarify where the Third World would stand in this new order. The Community has maintained that the notion of "Fortress

Europe" is a myth as the Community itself has to depend on global trade. The U.S. concedes that the EC remains a relatively open market. In the past couple of years, while focusing more intently on internal competition, the EC has been taking in greater volumes of imports compared to exports.

However, the EC market already is becoming increasingly self-sufficient. According to the International Monetary Fund, in 1975, 51.4% of total EC trade volume took place within the EC. In 1990, the total had risen to 59.2%. Trade with the fast-growing East Asian markets grew to 7.3% of EC totals in 1990 from just 3.6% in 1975. Trading with North America eased to 8.4% of EC trade in 1990 from 8.7% in 1975.

4.3 Principles and Guidelines for Trade Relations

The broad principles and guidelines drawn up by the Community for its trade relations with the Third World countries are:-

(a) that the achievement of the Single Market will benefit both the European enterprises as well as those from Third World Countries;
(b) liberalised and free international trade is essential for the Community, hence it will not resort to protectionism ;
(c) its multi-lateral and bi-lateral commitments with the trading partners will be respected;
(d) with the creation of the Single Market the National Legislative Measures will be replaced by Community Measures; and that
(e) the Community intends to seek a balance of advantages and reciprocity in their relations with Third World partners who would benefit by the economic advantages offered by the Single Market.

Where the 69 African, Caribbean, Pacific (ACP) countries, are concerned, the Community's relations should be enhanced through the LOME IV Convention, which will soon be put into force. ACP countries are accorded duty free access for their exports of manufactured goods and for most agricultural products not covered by the Common Agricultural Policy (CAP). In addition, the ACP countries will also be assisted through European Development Fund and European Investment Bank. In the case of the developing countries in Asia, Latin America and the non-EEC Mediterranean area, to which

category Sri Lanka belongs, the Community's economic relations will be maintained and strengthened through economic and development cooperation. This will include:-

(a) promotion of developing countries' trade through the medium of EEC's Generalised System of Preferences, provision for trade agreements and trade promotional activities,
(b) emergency aid;
(c) food aid;
(d) financial aid for rural development and regional integrated training;
(e) support for joint ventures between European firms and firms from those countries;
(f) support for Non-Governmental Organisations;
(g) research development programmes (agricultural); and
(h) special budgetary assistance for specific operations such as environment, drug abuse control etc. The Community's cooperation policy with the developing countries would also include promotion of regional integration, support for regional organisations and development projects with regional dimensions and trade-generating effects.

The Community's contention is that, more than at the government levels, interaction between the private sector in developing countries and Europe, by means of joint ventures will be advantageous to both sides. To this extent the Community will support integrated private sector development in the the developing countries. The Community has also stated that broad based-democracy, respect for human rights and economic reforms in developing countries will have a bearing on its economic relations with them.

5. EC POLICIES REGARDING IMPORTS

As 1992 draws to a close the external dimensions of the formation of the Single Market create growing interest and anxiety in the Third World countries. The integration does not necessarily mean that exports to the European market would become easier. The EC's trading partners will have to go through a process of adaptation to remain acceptable and competitive in the market.

5.1 Article 115

However, the single market does signal the end of Article 115 of the Rome Treaty. Under this article, the EC Commission can authorise member states to impose restrictions on imports when there is a threat to domestic industry. With the removal of border controls after 1992, recourse to Article 115 will no longer be possible.

5.2 Rules of origin

Rules of origin are necessary for the purposes of maintaining import restrictions like quotas and anti-dumping policies. The last substantial transformation involved in the manufacture of a product is generally adopted in the EC to define the rules of origin. Its interpretation in certain cases has led to the fear of its use as a protective device: for example for products like textiles and ceramics, there are specific rules pertaining to factors such as processing and value addition in determining the rules of origin.

5.3 Tariff Measures

The EC maintains a common external tariff with an average tariff rate of 7.8% (as against 6.2% in the United States and 8% in Japan). Average tariffs are considerably higher for food (13.8%) and textiles and clothing (10.5%). Under the GSP, the EC offers duty free access to a wide range of products. However, for sensitive industrial products which compete with EC industries, there are quantitative limits on duty free access. For agricultural products, GSP benefits are through reduced tariffs rather than duty exemptions.

Furthermore, since 1986, measures to graduate countries from the GSP for some products have been introduced. One of the major criteria for such graduation in that the country's share of exports of that industrial products exceed 20% (10% for textile products) of EC's total imports. The country's level of economic development and per capita income is taken into account in the graduation process. Hong Kong, Korea, China and Singapore will therefore lose their GSP status. The change is expected to have a significant effect on these economies. The GATT rounds of multilateral Trade Negotiations have been successful in substantially reducing the level of import tariffs maintained by the industrial countries including the EC.

5.4 Non-tariff Measures

Non-tariff barriers have been increasing in importance. This is indicated by the fact that non-fuel imports of developing countries affected by non-tariff barriers like quotas and export restraints increased from 19% to 23% between 1981 and 1987. In the EC member states (France, Germany and the UK) 33% - 54% of agricultural imports and 13% - 18% of industrial imports were subjected to non-tariff border measures in 1986.

Non-tariff related EC measures which affect imports:-

5.4.1 Voluntary Export Restraints (VER)

In May 1988, there were 138 VERs in the EC representing about half of all VERs maintained by industrialised countries. The use of VERs has been rapidly increasing. VERs are increasingly applied to imports from developing countries and affect agricultural products, textiles and clothing, machine tools, transport equipment and footwear.

5.4.2 Anti-dumping

Anti-dumping investigations have been frequently initiated by the EC. Although, Sri Lanka is not at present affected by such measures, there would be major implications for developing countries seeking to establish production facilities in the community.

5.4.3 Subsidies

A major form of EC subsidies affecting imports from developing countries relate to agriculture in the context of the common agricultural policy. There are also indirect and explicit subsidies to industry. One of the components of the Single Market Programme is the strict enforcement of competition rules in the EC countries. This implies that restriction on Government subsidies are likely to decline in importance in the Single Market.

5.4 .4 Public Procurement

Pubic procurement in the EC member states has strongly favoured national suppliers. As regards procurement from non-EC countries the EC will use a minimum value addition of 50% for eligibility to participation in the procurement processs. Sri Lanka has no immediate interest in this area having no industrial and technological capability to bid for such projects.

5.4.5 Technical Standards

Insistence on technical standards which favour local suppliers has been an important protective device adopted by the EC member states. The existence of differing technical regulations in individual Member States had forced manufacturers to concentrate on national rather than Community-wide markets. It had been necessary to have different production lines for different Member States. As a result, costs were high.

Differing technical standards result from differences between Member States in three types of arrangements :

a) technical regulations lay down the legal requirements enacted by the national parliaments, mainly in the interests of health and safety and the environment; often these regulations refer to standards.

b) standards are produced by national standardisation bodies (line DIN in Germany BSI in Britain): while they are only voluntary codes they often assume a quasi-legal status because of their use as a reference in technical regulations or contractual documents.

c) type testing and certification is used to check that a product complies either with voluntary standards or with statutory regulations : a typical problem is that one Member State does not recognise another's type-testing, entailing the costs and delays of additional testing.

5.5 Single Standards

The original approach to dismantling technical barriers was to attempt to harmonise national regulations across the Community. However, this proved a very difficult and protracted process; the relevant technology had sometimes even changed by the time that eventual agreement was reached. At the same time, increased concern for health, safety and the environment, and the rapid growth in technical innovation were adding to the occasions on which differences in national approaches and regulations were occurring.

The Community responded to this challenge by establishing compulsory requirements essential to the marketing or products;

a) creating harmonised European Standards by European standardisation bodies; and

b) as a transitional measures mutually recognising national standards until appropriate European standards are created.

In 1983, the Community adopted a Directive which required Member States to notify the Commission of new technical regulations for certain products prior to their enactment. The Commission was authorised to delay the introduction of these new regulations for up to a year.

A similar method was adopted regarding the preparation of national standards between national standardisation bodies and European bodies. This system, which originally covered only certain products, was extended in 1989 to all industrial and agricultural products and will apply to all EFTA (European Free Trade Association) countries.

To accelerate the process of removing technical barriers to trade, a new approach based on the following principles has been developed :

a) a distinction will be drawn in future internal - market initiatives between what is essential to harmonise in legislation and what may be left to be harmonised by European standardisation bodies;

b) legislative harmonisation will, in future, be restricted to laying down health, safety and other essential requirements;

c) harmonisation of industrial standards will be achieved by the elaboration of European standards. These European standards will be developed by the European Committee for Standards (CEN) or the European Committee for Electrotechnical Standardisation (Cenelec). As a transitional measure, and

in so far as harmonised standards do not yet exist, national standards may be recognised as equivalent through an appropriate procedure of approval by the Commission. The result will be that a product manufactured in one Member State in conformity with EEC legislation will be guaranteed automatic access to the markets of all other Member Stares.

5.6 The CE Mark

Each product for which harmonized EC regulations have been established will be provided with an identifying mark to be called the CE mark. This CE mark is sometimes referred to as the EC internal passport, since products bearing a CE mark, will be accepted within the EC. Without a CE mark, a hazardous product may not be traded or used within the EC even if it is in the country of production.

The use of the CE mark is only permitted if it can be demonstrated that a product conforms to the harmonized regulations. Hence, after 1992 products must bear a CE mark to be accepted in the EC.

There are three forms of certification to obtain the CE mark:

(a) For simple products, the producer or importer may himself write a declaration to the effect that the product conforms. He may then, without the involvement of a third party, put the CE mark on the products. In this event the onus lies solely on the producer or importer in the EEC, and for Third World country imports the exporter will be held liable.

(b) Where hazardous products are concerned, a declaration of this kind is generally not sufficient. The producer or the importer/ exporter then needs a certificate from an independent institute of inspection. The producer or the importer/exporter must have the certificate in his possession to put the CE mark on the product(s).

Unfortunately at present the independent institute of inspection has to be an 'Approved Body', located within the EEC, provisions for sub-contracting part of the certification process to Third World institutions have to be provided.

(c) For certain categories of products, the affixation of the 'CE' mark will require 'Quality System Certification' in accordance with the ISO 9000 series of Standards in addition to the product certification as outlined in (b) above.

5.7 Packaging & Labelling

"Packaging" usually refers to a system whereby goods are prepared for shipment, distribution, storage and marketing. Apart from the economic or technological aspects the legal regulation of packaging, as indicated earlier, both harmonizes the variety of existing practices and sets constraints for further development. Harmonization, at the very basic level, has been carried out through the Directives of the Community which provide for common rules concerning weights, volumes and quantities. One could also mention the Directives relating to prepackages by weight or volume of certain prepacked products (76/211 with subsequent amendments) and the corresponding Directive related to certain prepackaged liquids (75/106 with subsequent amendments).

These Directives regulate the standards for packaging, *i.e.* the acceptable differences between stated and actual quantities and the necessary markings such as nominal quantity, symbol of the packer or importer, and a small "e" as the EC initial verification mark (71/316/EEC). Moreover, they provide the range of permissible weights and volumes to which production must be restricted. In addition there are the Directives relating to bottles used as measuring containers (75/107/EEC) and aerosol dispensers (75/324/EEC). Both require, among other things, that the containers indicate the manufacturer and bear the signs indicated by Directive 71/316/EEC, certifying that the containers comply with or are exempted from EEC pattern approval. There are also requirements concerning weights and volumes and, in the case of aerosols, compulsory information to protect consumers from unsafe use.

5.7.1 Consumer Health and Safety

National food regulations protect consumers in different ways. Some states lay emphasis on the compositional standards and prescriptions of particular ingredients which must, or must not be used. Others, on the other hand, emphasize the provision of information through proper labelling to protect the consumers from being misled. Generally speaking, there is a trend from detailed compositional standards to more informative labelling. This change of practice can be attributed to two causes:

* The change of trading patterns, whereby an increasing amount of food is sold through self-service outlets. There is no one behind the counter, and the only information available to the consumer appears on the label.

* The increasing awareness, on the part of the consumer, of the nutritional, health and safety aspects of food and his wish to select products on the basis of the information available. Thus, food labelling has become the best source of information.

Nevertheless, certain issues cannot be satisfactorily solved by informative labelling. The fundamental principle in the above directive is the prohibition of misleading labelling by attributing to it effects or properties it does not possess, or by suggesting that the foodstuff possesses special characteristics when in fact all similar foodstuffs possess such characteristics. Nor should proper labelling, subject to the provisions concerning foodstuffs for particular nutritional uses, attribute to any foodstuff the property of preventing or treating human disease, or refer to any such properties.

The industrial sector and the national Governments in general are primarily concerned with the protection of the health and safety of consumers. Harmonisation of health and safety requirements, combined with mutual recognition of tests, test results and certification will remove the barriers to trade due to differing health and safety standards.

Such harmonisation of the rules on the manufacture and marketing of products is supplemented by minimum harmonisation of the rules on the protection of workers at the workplace (including minimum health and safety requirements for the use of machinery and minimum requirements for the use of personal protective equipment at the workplace.

In the years to come, new safety demands will be set in the whole EC for hazardous products. At the same time, the EC has decided to limit these legal demands to what is strictly necessary.

5.7.2 Environment Protection

Apart from setting standards on safety, the EC is concerned about the effect of the product on public health and the environment. The protection of the environment also sets a number of constraints in packaging. Directive 85/339, on beverage containers for example represents an early attempt of the Community to regulate the recovery and recycling of material from household waste. The implementation by Member States of Directive 85/339 has lead to the establishment of national disposal schemes, such as the German Dual System, which, according to the European Commission, "are at the root of obstacles to the free movement of goods within the Community" (Draft Proposal of 21 February 1992). Given the collapse of attempts to amend Directive 85/339, the European Commission has been working on a proposed comprehensive directive on packaging and packaging waste. This will be adopted in two years.

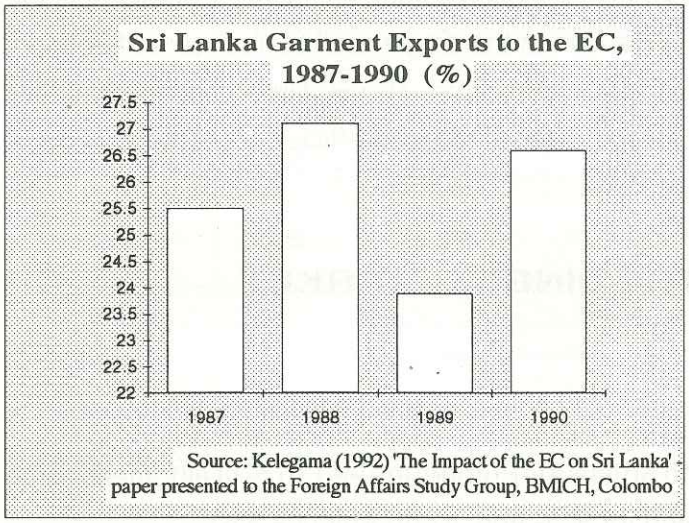
Thus, the shape of EC trade policies after 1992 will depend on the magnitude and content of the adjustment and restructuring process undertaken in the context of the Single Market Programme. It appears that the adjustment process will be painful for inefficient industries particularly with the onslaught of increased competition. Looking at trends and the content of recent policies, it is likely that the EC will seek to contain the costs of the adjustment process by resorting to appropriate protection from non-EC imports.

6. THE IMPACT ON TEXTILES

From the 1960s there have been quota systems affecting trade in textiles and clothing. The current arrangement - MFA IV which commenced in 1986 will expire in December 1992, but is likely to be "rolled over" for 12-15 months. As part of MFA the EC has entered into bilateral restraint agreements with developing countries. There are overall quotas for about 370 product categories. These include regional quotas and restraints on imports placed in particular EC countries under Article 115 of the EEC Treaty. The EC supports the eventual integration of the textile sector into the GATT, when certain 'fair' conditions for competition are met.

The most important way in which the single market programme would affect trade in textiles and clothing arises from the incompatibility of national quotas with the removal of border controls. Thus, theoretically only EC - wide quotas on textiles and clothing can be imposed. Recourse to article 115 authorisation to impose national restrictions would also not be possible with the removal of border controls.

The prospects for exports of textiles and clothing by developing countries such as Sri Lanka will depend more on the outcome of the Uruguay Round rather than the impact of the single market. Given the importance of this sector in terms of employment in the EC there is little doubt that strong protection for this sector will continue even after the MFA expires. The incompatibility of national quotas with the single market objective will be beneficial to Sri Lanka, in injecting some flexibility in the direction of exports unless such opportunities will be balanced by strong safeguard devices. The marginal nature of enhanced cost competitiveness of EC products, induced by the single market measures imply that our exports are unlikely to be displaced by increased EC production.



Source: Kelegama (1992) 'The Impact of the EC on Sri Lanka' - paper presented to the Foreign Affairs Study Group, BMICH, Colombo

7. THE IMPACT ON FOOD PRODUCTS

Nearly 10 million workers were employed in the EC agricultural sector in 1987 - 6% of total employment. Given the large size of the agricultural work force, the EC policy makers will continue to place considerable importance upon agricultural interests in trade policy design and implementation.

The single market programme does not, however, include any policy changes pertaining to the common agricultural policy (CAP). The provisions in the single market

programme pertaining to agricultural products relate mainly to harmonization or approximation of standards in areas such as the use of additives, colours, flavourings, preservatives, anti-oxidants, artificial sweeteners, sugar substitutes, packaging, labelling and irradiation and advertising, and particularly those applicable to items such as quick frozen foodstuffs, fruit juices, jams, jellies, purees and marmalades. The harmonisation of these standards would theoretically make it easier for developing countries to export to EC countries since there would be no country specific standards but just the EC one.

However, a single market would also increase competitiveness. For example the EC has estimated that the removal of barriers in the single market on foodstuff industry would result in savings of about 2 - 3% in total value added. The EC also expects substantial gains if EC companies can restructure and raise industry efficiency. This would put pressure on imports.

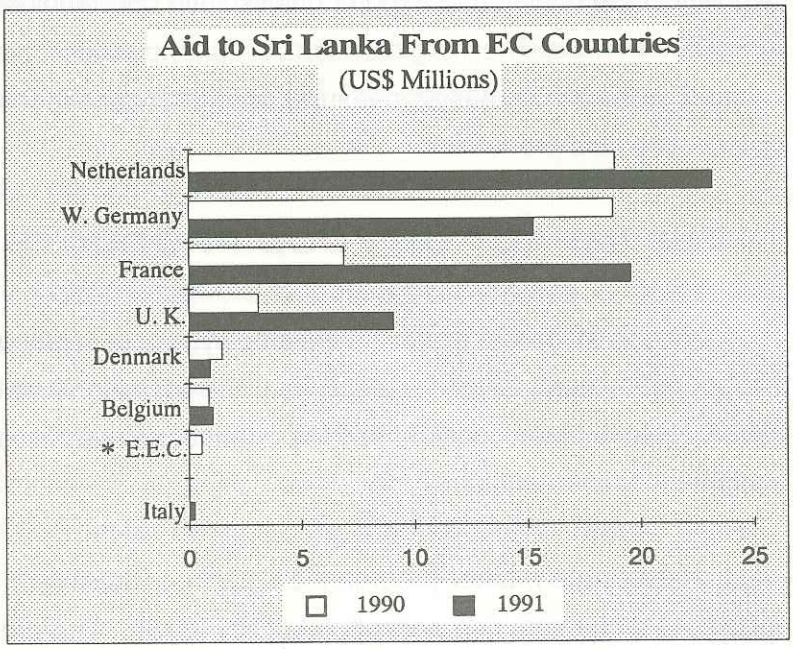
8 IMPLICATIONS OF THE SINGLE MARKET FOR SRI LANKA

8.1 Tourism

The largest source of tourists to Sri lanka is Europe. In 1990, 57% of all tourists came from Western Europe (Asia accounted for 34% and North America 3%)

8.2 Foreign Aid

In terms of net foriegn assistance to Sri Lanka, the EC made a significant contribution by producing Rs1623 million in net loans and grants in 1990. This accounted for 8.6% of all assistance (compared to 10.3% from USA and 28.3% from Japan).



8.3 Trade

In the global context Sri lanka's share of the EC market is negligible accounting for abut 0.03% of EC's total imports. However, the importance of EC as a major trading partner for Sri Lanka has increased over the years. The trend has been towards an increase in exports and a decrease in imports; in both 1989 and 1990, Sri Lanka recorded

Sri Lanka's Trading Partners, 1990

	Imports	Exports
USA	8%	26%
EC	14%	25.9%
Japan	13%	6%

Sri Lanka - EC Trade(%), 1985-1990

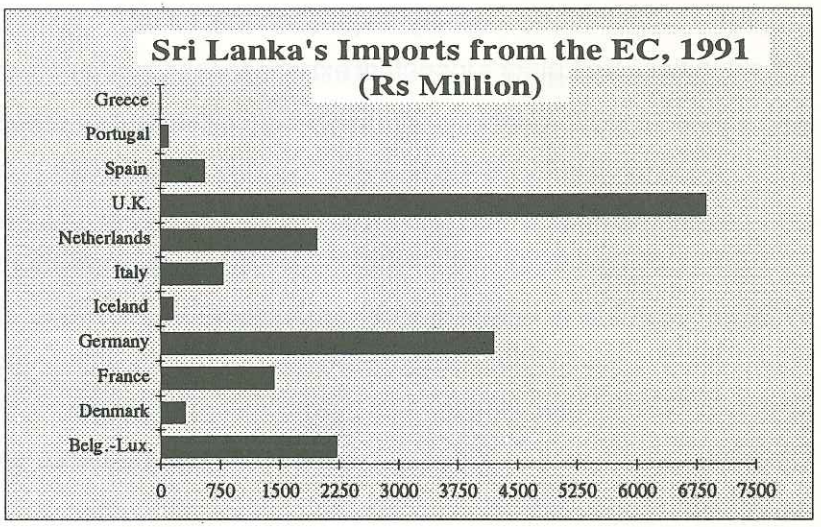
	Imports	Exports
1985	15.5	18.9
1986	15.0	23.0
1987	17.2	22.0
1988	17.3	23.5
1989	16.6	25.6
1990	14.7	25.9

Source: Dept of Commerce, Monthly Bulletin of Statistics, Dec,1990

a trade surplus of Rs 1463 million and Rs 3891 million respectively. Within the EC, Sri Lanka's major trading partners are Germany, UK, Belgium, France and Netherlands.

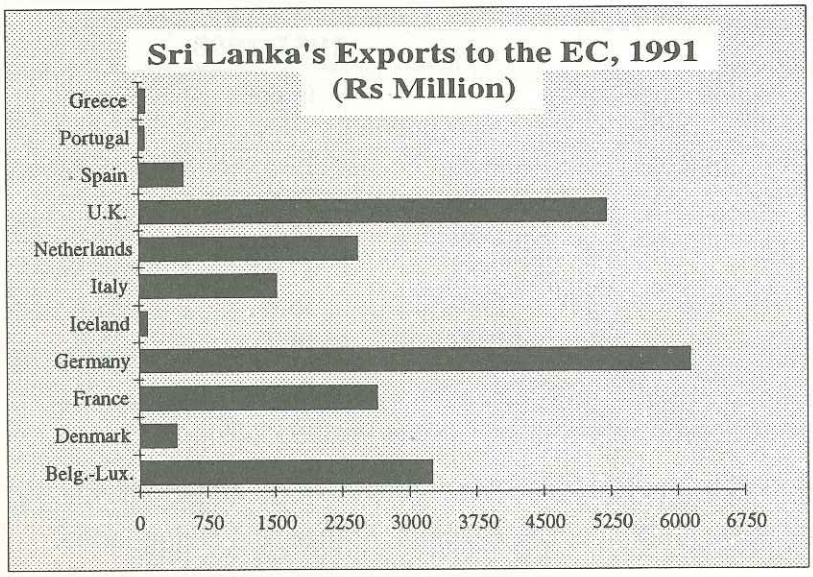
8.3.1 Imports

Sri Lanka's imports from the EC as a % of total imports dropped in 1991 to 14.7% from 21% in 1980. However, the rupee value of imports have increased from Rs.7,396 million in 1980 to Rs.18,441 million in 1991.Imports from the EC mainly consist of electrical machinery and mechanical machinery. As a percentage of GDP, Sri Lanka's imports from the EC in 1991 was 0.055%.



8.3.2 Exports

Sri Lanka's exports to the EC as a % of total exports, has risen to 26.7% in 1991 from 20% in 1980. The value of exports to the EC countries has risen from Rs.3,617 million in 1980 to Rs.22,438 million in 1991.As a buyer of Sri Lanka's exports, the EC is second only to the USA. About 75% of total exports to the EC consists of only five items - tea, rubber, coconut products, garments and diamonds. In 1990, the EC accounted for 12% of tea exports, 32% of rubber exports and 24% of garment exports.



Most of Sri Lanka's exports to the EC enter duty free either under MFN or GSP. These include Tea, Rubber, Precious and Semi Precious stones, Cinnamon, Graphite, etc. Sri Lanka has requested further GSP concessions for items such as Coconut oil, Fresh foliage, Passion fruit juice, Fresh cut flowers, Gherkins, etc.

8.3.3 The Impact of the EC on Sri Lanka

The removal of the internal barriers will create a large and more homogeneous European market. Such a market would be intensely competitive and only the best prepared Third World country exporters will be able to take advantage of the new opportunities. Sri Lanka's industrial exports to the Community remain marginal, compared with that of the agro based sector. This reflects the basic weakness of Sri Lanka's industrial export sector and the consequent unavailability of tradeable goods in sufficient volume and at competitive prices. The answer may partially be to look for joint ventures in selected areas with Community enterprises, with possible buyback arrangements. This would involve a comprehensive evaluation of Sri Lanka's export and investment promotion policies and a vigorous drive to promote joint venture arrangements. In looking for such opportunities Sri Lanka will have to bear in mind, that the increased factor mobility within the Community itself following the creation of the single market may not encourage many EC manufacturers to go outside for investment.

Consumer demand for many products varies within the Community because of differences in taste, habits, language, culture and income. In fact, the diversity of consumer tastes and of the products and services needed to satisfy them may increase as incomes are expected to rise in the post 1992 period. Sri Lanka may hope to exploit these differences by identifying particular market segments and catering to them.

The removal of internal trade barriers is unlikely to affect the pattern of imports of tropical agricultural products and raw materials from developing countries as the EC has always imported these items. Difficulties for Sri Lanka in this area would arise in the event of the EC extending further concessions to ACP countries for similar products. As for processed agricultural products Sri Lanka cannot rule out the possibility of community processors merging to achieve economies of scale in the enlarged market. Sri Lanka may find it necessary to work in association with other countries in the same position to strengthen and extend the Community GSP Scheme as a means of protecting Sri lanka's export interests.

Since the single market would help the economic growth rate of the EC through realisation of economies of scale and reduction in costs of transport and handling, the growth effects on EC imports from developing countries such as Sri Lanka are likely to suffer due to trade diversion. Further, one might conclude that those EC interests that had to gain from keeping out imports from non-ACP developing countries would have some success even after 1992 if the EC remains protectionist, particularly for tropical agricultural products, leather goods and footwear, clothing and consumer electronics.

The EC's declared intention to seek reciprocal treatment from its trading partners on services etc, may create difficulties for Sri Lanka in the area of shipping and intellectual property rights. Although the EC has stated that in applying the concept of reciprocity it would take into account the level of development of its trading partners, eventually this will amount to hard negotiations with individual countries. How far the Community would stretch itself to honour its promise when its own vital interests are involved is yet to be seen.

8.3.4 Proposals to Remain Competitive

Sri Lanka faces opportunities and problems in the emerging single market. The following proposals are geared towards meeting the threats and profiting from the opportunities offered.

1. The identification of sectors where special policy instruments could be utilised for inducing appropriate changes required for exports to the single market.

2. Technological upgrading and establishing new manufacturing units embodying needed technology in the identified sectors so that the country could manufacture the kind of products required by the EC as well as maintain their competitiveness. This could be facilitated through;
   (a) introducing appropriate changes in trade policy to encourage import of capital goods and technology ;
   (b) provision of adequate investment finance for the export production sector; and
   (c) liberalising conditions for foreign invest ment in selected sectors.

3. Increasing exports to the single market involves greater emphasis on certain aspects of the export process *e.g.* market studies and appropriate selling strategies. To this end provision of market information, availability of finance for export marketing and development, and the establishment of joint ventures to increase the competitiveness of exports would become important.

4. There is considerable scope for regional co-operation in promoting exports in the context of the SAARC; such co-operation could take the form of sharing of information, sponsorship of indepth studies of issues relating to exports to the single market, the establishment of a regional fund to support investment finance for exports, export marketing and other export development measures and promoting joint ventures between Asian developing countries.

5. Given the difficult conflicts and trade offs involved in the policy changes for sustaining export growth to the single market, one option available to Sri Lanka

could be to promote increased exports to non-EC markets to compensate for any decline in the EC market share induced by market forces in the Single market. However, there are problems in considering such an option. First, since the EC represents a large market for our products it is difficult to see how any decline in the market share can be taken up by other countries without appropriate policy changes. Second, increased exports to non-/EC developed markets such as USA involve the same type of policy efforts needed to promote trade with the EC. Finally many of the technological changes required to be adopted by Sri Lanka ought to be a "natural" implementation of the development strategies. Therefore, any attempt to dampen this process and seek the easy alternative of exporting products embodying traditional technology to less demanding markets would be unfavourable. Thus, the only feasible alternative is to consider policy changes required for sustaining exports to the single market especially since rapid overall export growth is an important component of Sri Lanka's development strategy.

9. THE EUROPEAN ECONOMIC AREA (EEA)

9.1 Objectives

1993 would also witness the creation of an European Economic Area (EEA) between the community and the EFTA countries. The main objective behind the creation of the EEA is to extend the benefits of the EC Single Market to seven -nation EFTA Countries; the free movement of goods, labour, capital and services. The second objective is to pave the way for neighbouring EFTA Countries to satisfy their desires in obtaining the benefits of the Single Market in the interim period before their applications for full membership with the EC could be considered. The EC has decided that owing to the lack of infrastructure facilities, it cannot accommodate any more members at least until 1995. The third objective is to gradually initiate measures to enlarge the Community towards a "Wider Europe" in the long-term.

According to the Agreement, the dimensions of the EEA will be confined to the extension of the benefits of the Single Market to the EFTA Countries. The EEA as it is, is not a Customs Union, nor a Monetary or Political Union. However, the EEA will bring about a dramatic change in the quality of relations between the Community and the EFTA

Countries. From January 1993, the EEA will have a market of 380 million consumers stretching from the Arctic to the Mediterranean.

9.2 EC EFTA Trade

65% of EFTA's trade is with the European Community and 25% of the EC's trade is with EFTA Countries. A major portion of this trade is carried on by rail. Together, the EC and EFTA account for almost half of world trade. In 1990, they made up 47.2% of world exports and 46.2% of imports. Most of this trade is carried out with each other within this economic group. In 1990, 68% of the EEA trade was internal. The EEA would become the world largest trading bloc and the richest open Single Market. Dismantling of barriers would enhance the already substantially developed internal market.

Existing free trade agreements provide mainly for the abolition of Custom duties and quantitative restrictions in trade and in industrial goods. The EEA agreement will remove other trade barriers and add to the free movement of people, capital and services as well. These freedoms will be achieved through the application by the EFTA Countries of the Community Legislation, subject to specific adaptations, transitional periods and in some cases derogations.

In order to ensure equal conditions of competition through the EEA, the EFTA Countries will also take over the Community's competition rules and crate an independent EFTA Surveillance Authority and an EFTA Court.

9.2.1 The Removal of Barriers to Trade and Investment

The free movement of goods implies that technical barriers to trade will be removed as the Community's legislation concerning norms and standards will, with minor exceptions apply throughout the EEA. Among further liberalizing measures EFTA countries will abolish any discrimination by monopolies and open contracts by public sector organizations on the basis of Community rules. As EEA is not a Customs Union, the free movement of goods will apply to goods originating within the EEA and not to goods imported from outside. Border Controls will therefore not be removed, but they will be simplified as much as possible.

Special arrangements have been negotiated to cover sensitive sectors such as fisheries and trade in agricultural products. EC's Common Agricultural Policy (CAP) will not

apply to the EFTA.

In the Service sector, the liberalization would mean under the EEA, that a Company already established in a Member Country, would automatically be able to operate in any of the 19 nations of the EEA, provided it has obtained the License for its operation from any Member Country of the EC. This would apply to all services such as Banking, Insurance, Communications and Transport, etc.

In the area of capital movements, any discriminatory restrictions will have to be abolished to ensure that the conditions for investment and capital transfers are the same for all nationals and companies established throughout the EEA.

Concerning workers and self-employed people, the EEA Agreement gives them the right to move and establish themselves freely within the Community. Their educational qualifications will be recognized. No discrimination will apply through the EEA including the area of social security.

Apart from free movement of goods, labour, capital and services, the cooperation will cover so-called horizontal and flanking policies that will apply to all aspects of competition, embracing company laws, research and development, the environment, consumer protection and social policy.

9.3 The Impact of the EEA on the EC

The EEA is an important element of the Community's proposed enlargement to be put in place following the dramatic geopolitical changes in Europe since 1989. The EEA can stand on its own as an alternative to EC membership for EFTA Countries. But it is perceived by some of them as a prelude to full Community membership. Jacques Delors, President of EC, has described it as a trial run for those seeking to join the EC. Austria, Sweden, Finland and Switzerland have already formally applied for EC membership. Norway would do so in November 1992. In the event of EC granting full membership to these Countries after 1995, EFTA will be dismantled or confined to only Iceland and Liechtenstein.

The EEA provides for EFTA Countries to incorporate into their national laws some 10,000 pages of existing EC legislation. Most items to be covered by a full membership have been settled thorough the EEA.

10. CONCLUDING REMARKS

The EEA could be considered a considerable advantage for Third World trade with the member Countries of EFTA since similar standards as laid down by EC for Third World products will become acceptable in the EFTA Countries form 1993. This could be considered as a trade facilitation factor for expansion of trade with EFTA member Countries.

The EEA will not alter the existing relations the Member Counties have with the Third World. EFTA members are still autonomous Countries. Their import duties on Third World imports will remain. There will be no common external tariff as in the case of EC.

Better opportunities would emerge for enterprises in the Service sector to penetrate into EFTA Countries as, for instance, a banking operation from a Third World Country in a Member Country of the EC, would automatically be accepted in any one of the present EFTA Member Countries. This will apply to all fields in the Service sector.

While the above implications are favourable to developing countries including Sri Lanka, certain factors could turn out to be otherwise. They are: (a) the competition in the EEA and (b) high standards and qualities of products.

The developing countries should therefore concentrate on improving their competitive edge and take measures to comply with EC standards as laid down by EC regulations for imports from Third World Countries.

The establishment in 1993 of the European Economic Association is bound to open up for Third World countries avenues for a potential expansion of trade. The economic gains that are expected to be achieved by the EEA would in turn generate greater demand for consumer goods - and this is where the Third World countries could seize the opportunity to develop and expand their trade - with the offer of goods - enhanced both in quality and quantity.