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May 18, 1994

To: Members of the Executive Board

From: The Secretary

Subject: Economic Union - Common Policies and Recent Institutional Developments - Supplementary Materials - Annexes

The attached paper provides supplementary material for the seminar discussion of common policies and recent institutional developments of the European Union (SM/94/120, 5/12/94), which is tentatively scheduled for Monday, June 6, 1994.

Mr. D. McDonald (ext. 38862) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

European Union: Common Policies and Recent Institutional Developments

Supplementary Materials--Annexes

Prepared by the European I Department, the Policy Development and Review Department, the Research Department and the Office in Europe

May 18, 1994

Contents | Page

		Page
I.	Council Recommendation of the 22 December 1993	1
II.	Completing the Internal Market: A summary of the key directives passed and of pending issues	8
III.	Recent Developments in the European Union's Common Agricultural Policy	12
IV.	European Agreements	21

Tables

1.	European Union: Self-sufficiency in Major Agricultural Products	14
2.	Developments in the Trade of Central and East European Countries with the European Union, EFTA, the United States, Japan, and Canada between 1989 and 1992	23
3.	Association Countries: Trade Composition by Partners	24
4.	Trade Between the European Union and Association Countries	25
5.	Association Agreements: Summary of Concessions, General	27
6.	Association Agreements: Summary of Concessions, Textiles and Clothing	30
7.	Association Agreements: Summary of Concessions, Steel and Coal	31
8.	Association Agreements: Summary of Concessions, Agriculture	32

COUNCIL RECOMMENDATION

of 22 December 1993

on the broad guidelines of the economic policies of the Member States and of the Community

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 103(2) thereof,

Having regard to the Recommendation from the Commission,

Having regard to the conclusions of the European Council of 10 and 11 December 1993,

Hereby recommends:

Article 103 of the Treaty establishing the European Community provides the framework for economic policy coordination from the start of Stage II of the process towards economic and monetary union. The economic policy guidelines adopted under that Article will constitute the reference for the conduct of the economic policies in the Community and in the Member States.

1. Main objectives

There are signs that the recession is bottoming out in the European Union. Output indicators and business surveys in a number of countries are showing signs of improved confidence and prospects. Long-term interest rates have declined substantially and most European central banks have lowered their leading rates. However, unemployment continues to increase in most Member States. Against this background, the broad guidelines for economic policies in 1994 should aim, as a priority, for the return of a sustainable and non-inflationary economic growth.

The Community should set itself the objective of, in the short term, reversing the trend and then, before the end of the century, significantly reducing the number of unemployed, at present standing at the unacceptable level of 17 million. A decrease in unemployment is imperative to reduce the negative economic and social consequences arising from this wastage of human resources. Higher employment creation is also necessary to achieve a more active society where all those wishing to join in the production process are given a chance to do so and where the weight of the factors leading to social exclusion is substantially reduced.

This employment objective should be obtained by a non-inflationary, strong and employment-creating growth, lasting over many years and respecting the environment. Higher growth is essential not only in relation to employment creation but also to enable the Community to reap the benefits of the internal market, to improve its economic and social cohesion and to meet its growing commitments in relation to the rest of the world. Since growth cannot be artificially generated, it must be brought about essentially by the effect of market forces and by the dynamism of the internal market, open to the outside world. The conclusion of the GATT negotiations on a global, durable and balanced basis and the Community's openness to new markets has a vital role to play in this respect.

Achieving a higher growth rate also requires a strengthening of economic convergence among Member States. Convergence will set in place the conditions for stronger job-creation and will allow the Community to reap the full benefits of the internal market. It will also make possible a successful transition to EMU.

In this respect the task of economic policy-makers is to allow market forces to display their full potential by:

(i) providing a stable and coherent macroeconomic framework;

(ii) removing the macro- and microeconomic obstacles to growth.

In the present situation the challenge is a dual one. Firstly, to act decisively to improve the conditions for growth consistent with the commitment to the creation of high employment in the medium term. Secondly, to create the economic and social conditions which will permit stronger, sustainable and more employment-creating growth in the medium to longer term.

The recovery process will require a restoration of confidence through a rebalancing of the current macroeconomic policy mix combined with credible structural measures. The sooner current and expected pay and budgetary trends incorporate the price stability objective, the sooner interest rates can be further reduced substantially on a sound basis. For lower interest rates, achieved on this basis, represent an important element to boost short-term prospects in the Community. Given the severity of the present *situation, however, and the size of the budgetary adjustment to be* undertaken in many countries, the recovery process may well be modest and hesitant. Therefore, the full realization of the initiatives agreed at the European Council meetings in Edinburgh and Copenhagen is of paramount importance.

In the medium term, policies and behaviour must remain consistent with stability. They must help to overcome rigidities and to put an end to the damaging reduction of national saving resulting form high budget deficits, thereby strengthening the investment conditions and the growth potential of the Community so that many years of stronger and more employment-creating growth become possible.

2. Economic policy guidelines

In order to create the conditions to realize the Community's economic objectives, in particular the increase of employment and the reduction in unemployment, the Council adopts the following broad economic policy guidelines:

2.1 Price and exchange-rate stability

The Community will aim to keep a stable macroeconomic framework. A rate of inflation of no more than 2 to 3 percent should be reached in most Member States by 1996 as a step towards price stability in the Community.

All policies and behaviours should be consistent with this objective. Those Member States who have already reached this level of inflation should ensure that policy measures are consistent with the maintenance of this performance. For the other Member States, determined action is needed to provide the basis for lower short-term and long-term interest rates, for example involving action related to budgetary consolidation, wage evolution and inflationary price developments in the services sector.

If these measures are implemented with sufficient speed, conditions would be established for both nominal and real interest rates to come down as inflation expectations are reduced. The setting up of the EMI will represent an additional factor of stability and co-operation, given the important role it will play in strengthening arrangements for the coordination of Member States' monetary policies and in monitoring the functioning of the European Monetary System.

The high degree of integration and the reaping of the benefits of the internal market demand that the Community continues to aim for exchange-rate stability built on common efforts to make progress on convergence and to create sound economic fundamentals in all Member States of the Community.

The Community reaffirms its commitment to the EMU process and timetable as agreed in the Treaty on European Union. To this end it will intensify its efforts at achieving economic convergence.

2.2 Sound public finances

The restoration of confidence requires that in 1994 Member States prevent any further deterioration in their budgetary situations and carry forward the process of deficit reduction. In those Member States facing more worrying fiscal positions, confidence will benefit from an immediate strong pursuit of the consolidation process. This holds true especially for Member States with very high and rising public debt ratios. The consolidation process should intensify in those Member States with high budget deficits and which are expected to face a relatively favourable economic situation in 1994. In other Member States tight control of budgets will be necessary in 1994 but the emphasis should mainly be on credible medium-term consolidation strategies with measures to be already announced now which will take effect in future years as the recovery strengthens. At the Community level, the limits on EC spending and revenue agreed at the Edinburgh Council must be respected.

In 1995, Member States should continue action to make their public finance positions sustainable again. Under the expected growth path for the years ahead, this means action towards reducing budget deficits to the reference value indicated in the Treaty on European Union (3 percent of GDP). Most Member States have the potential to reach this goal by 1996, with the others needing more time. This action will contribute to meeting the criterion relating to public debt provided for in the Treaty.

The measures used to stabilize public budgets will give priority to reductions in current expenditure and to improving the efficiency of the tax system, for example, by strengthening action against tax evasion. All Member States need to reorient public expenditure to more productive uses and to increased investment in particular.

In the long term, Member States' budgetary policies will be directed towards contributing to higher national savings and investment. This will entail much lower budget deficits (perhaps close to balance by the year 2000).

2.3 Creating more employment

Member States and the Community will take resolute action to improve the functioning of their economies, aiming specifically at improving competitiveness and the Community's capacity to create jobs.

Because of the institutional, legislative and contractual peculiarities of each Member State, the Community's action must focus on defining objectives, while leaving Member States free to choose the means appropriate to their situation within a general framework defined in common. With this in mind, the Council considers that, in order to strengthen the capacity of the European economy to create jobs, Member States should draw on suggestions from the Commission White Paper.

2.4 Pay, investment and employment

Member States set themselves the objective of a significant increase in the share of investment in GDP. Meeting this objective is essential in order to increase the Community's potential for sustainable non-inflationary growth of the European economy in the medium and long term. Moreover, the recovery in private investment will, in the short term, help to stimulate demand.

Recovery in investment will be possible if society is prepared today to make the efforts which will bring more prosperity and more jobs tomorrow. That calls, amongst other things, for pay developments consistent with the improvement in the profitability of investment and in the competitiveness of European undertakings on world markets. That process will also contribute to promoting job-creation in the immediate term.

In the short term, the need to create new jobs will not permit real pay growth in most countries and may result in real pay reductions in certain sectors of the economy. However, pay movements should provide for an appropriate differentiation according to the situation in Member States, industrial sectors and firms, as well as vocational qualifications and work experience.

To this end, governments and the social partners will use all instruments which national procedures provide to ensure that pay trends in their countries adapt rapidly to the objective concerning inflation.

Pay moderation in the public sector is also important, on the one hand to take the pressure off public finance and to accelerate promotion of public investment and on the other to set an example for the private sector.

Schemes promoting new forms of labour organization on a sound economic basis may be introduced through negotiation in a decentralized way (at sector or enterprise level).

2.5 Reducing the indirect cost of labour

Where appropriate, Member States must intensify their efforts to bring about a significant reduction in the indirect cost of labour. Such reduction would enable a better balance to be achieved between the costs of the various production factors. Failing that, the labour factor, in particular low-skill labour, would suffer excessively.

Action to be undertaken in this field has a twofold objective:

(i) it should promote job-creation in services responding to new society needs, the development of which is currently discouraged by the high level of the indirect cost of labour;

(ii) combined with pay moderation, it should also save jobs in the sector exposed to international competition by curbing the replacement of labour by capital and the relocation of activity.

In order to encourage the process in the right direction, Member States are invited to examine to what extent an adaptation of the financing mechanisms of their social protection system, along with saving measures, could further contribute to the promotion of employment. However changes in the systems should not increase Member States' indebtedness. The question will be re-examined at Community level on the basis of reports which Member States are invited to present. Fiscal measures possibly relating, inter alia, to the environment could be one of the means of offsetting a drop in social contributions, within a general context of stabilizing all statutory contributions and reducing the tax burden.

2.6 Active policies towards employment

Meeting the objective will also depend on adjusting employment policies to the changing economic environment.

Member States are invited to:

(i) improve educational and job-training systems so that those who enter the labour market have the possibility of developing professionally and at the same time have skills that are useful to undertakings;

(ii) help reintegrate the long-term unemployed in the labour market;

(iii) improve the functioning of local placement services;

(iv) remove excessive rigidities which prevent the labour market from functioning effectively;

(v) improve labour mobility;

(vi) promote liberalization measures aimed at sheltered sectors, including, where appropriate, the services industry.

2.7 Completing the internal market

The existence of a large export-oriented internal market is a major asset of the European economy, and it must be fully exploited. The full incorporation of Community legislation into national law, simplification and reduction of the legislation, the creation of a fiscal, administrative and financial environment favourable to small and medium-sized enterprises, the application of the competition rules and the control of State aids are essential elements in the completion of the internal market.

Likewise, the capital market must be made more efficient in order to encourage a flow of savings into productive job-creating investments.

The trans-European networks are also an essential element for the effective operation of the internal market and the reinforcement of economic competitiveness. The Council will make full and rapid use of the new possibilities offered by the Treaty (Article 129b).

The economic policy guidelines laid out above will constitute the reference for all future multilateral surveillance exercises. The implementation of the guidelines will be monitored in accordance with the procedures laid down in the Treaty. The Council will also assess the implementation of those guidelines in their assessment of Member States' convergence programmes.

Completing the Internal Market: A summary of the key directives passed and of pending issues 1/

This annex provides a synopsis of the key actions taken since the mid-1980s as part of the initiative to break down regulatory barriers to the free movement of goods, services, and factors and summarizes the principal outstanding issues. Its principal focus is on measures incorporated in the Internal Market Program but also covers specific measures initiated after the adoption of this program as well as general areas not covered in the program.

1. Border controls and indirect taxation

The elimination of border controls on goods, services, and capital took effect at the beginning of 1993. At the same time, a new transitional VAT system was implemented that established a minimum standard tax rate of 15 percent. Countries are also allowed two reduced rates of at least 5 percent, but luxury rates are no longer allowed. There are temporary arrangements for countries with zero rated products. Spain and Luxembourg can operate super-reduced rates (minimum 3 percent) on an agreed list of products. The transitional system remains based on the "destination" principle. The "definitive" VAT system, planned for 1997, will be based on the origin principle. Minimum excise taxes have also been established for tobacco, mineral oils, and alcohol.

2. Harmonization of direct taxation

The white paper did not include proposals for harmonizing direct taxes, reflecting the reluctance of member states to release sovereignty in this area. Unlike most areas of the internal market, unanimity is required for EU legislation on taxes. Two directives were adopted in 1990 dealing with rollover relief for cross-border mergers and take-overs and the abolition of withholding taxes on inter-group cross-border dividend payments. Also during 1990, an intergovernmental convention was agreed, providing for an arbitration procedure concerning the elimination of double taxation. The current focus of the Commission is on eliminating double taxation and two proposals are before the Council of Ministers, one on cross-border taxation of interest and royalty payments between related enterprises and the second on the consolidation of losses of foreign branches. A common withholding tax on interest income was proposed in 1989, but subsequently set aside due to the opposition of a number of countries. There is continuing interest in this area but no sign of a breakthrough. Over the years there have been various proposals for the harmonization of corporate taxes. In March 1992, the Ruding Committee recommended inter alia a minimum corporate tax rate of 30 percent, but the Council of Ministers and the Commission had reservations about the proposals. In the area of labor income, there is currently a proposal from the Commission to grant nonresident workers the same tax

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1/ Principal contributor: Mr. Laxton (RES).

treatment as resident workers whenever their income in their country of residence is too low to have full access to available tax benefits.

3. Identity controls

The white paper programme deadline for the removal of border controls on persons has not been met. Only one of the proposed white paper directives was tabled. Instead, the Commission has preferred to allow an inter-governmental solution to be found. Nine countries (EU members other than Denmark, Ireland, and the United Kingdom) have signed the so-called Schengen Agreement, which provides for the removal of internal frontier controls subject to various accompanying measures being met. 1/ Delays in the implementation of this agreement are attributed to problems in bringing on-line a computer system--the Schengen Information System--that would inter alia help monitor illegal activities. The European Parliament has taken a case against the Commission to the European Court of Justice for failing to introduce proposals for the abolition of border controls on persons. A ruling is not expected for some time. Recently, the Commission, using new powers of initiative acquired under the Maastricht Treaty, has introduced two proposals including one dealing with visas for citizens of third countries.

4. Technical standards

Two approaches to the harmonization of technical standards have been adopted. Following the so-called "old approach"--characterized by precise definition of technical standards--work has been completed or largely completed inter alia on food products, fertilizers, cosmetics, tractors, pharmaceuticals, and automobiles. Emphasis has shifted to a "new approach" under which directives define essential requirements which a product has to meet but the drawing-up of harmonized standards is left to European standards bodies. The European Organization for Testing and Certification was created at the end of 1990 based on the principle of mutual recognition of testing and certification. While the legislative program from the 1985 white paper is virtually complete, the Commission is concerned that, owing to the slow progress in developing harmonized standards, there are still important differences in national technical standards which can, in some cases, result in important barriers to free trade.

5. Liberalizing capital movements

Capital movements have been completely liberalized except for restrictions on short-term capital flows authorized for Greece under derogations that expire at end-June 1994. The Greek authorities have indicated their intention to complete the liberalization process by that date.

1/ Of the nine, Italy and Greece have not yet ratified the accord.

6. Liberalizing labor movements

Directives have been issued concerning the recognition of university diplomas and work is currently underway to develop rules for the comparability of vocational qualifications.

7. National company law and the European company statute

A number of directives have been passed including those dealing with transparency in changes in major holdings, branch accounts, and single-member companies. Other directives dealing with limited company structure, take-over bids and cross-border mergers have been given lower priority or blocked. Presently, priority is being attached to passage of the European Company Statute.

8. Intellectual and industrial property

A directive has been passed harmonizing national trademark laws, the Community Trade Mark Office has been established and a Council regulation on the EU Trade Mark has been adopted. A convention has been signed on a Community patent, though not yet ratified. Protection of biotechnological inventions and of data bases is presently under discussion.

9. Energy

The energy sector was not included in the 1985 white paper. To date directives have been passed to ensure access to pipelines and grids for energy in transit between EU states or from third countries, and to foster transparency in pricing. The efforts to introduce competition into the electricity and gas industries has made little progress to date. A 1992 Commission proposal included: the unbundling of transmission, generation, and distribution from one another; the encouragement of new independent investment and production; and the provision of third party access to distribution and transmission networks. The proposal was not favorably received in the Council of Ministers or in the European Parliament, in part on account of the scope of liberalization but also in the belief that change should be more gradual. The Commission made new proposals in December 1993 that were much less ambitious and provided significant scope for member derogations. Under the new proposals unbundling would only go as far as separating the relevant accounts and third party access would have to be negotiated. If progress toward effective competition is not made through EU legislation, the Commission may use a judicial approach. Proceedings were opened in 1991 against many member states which maintained exclusive import and export powers in electricity and gas, but were subsequently suspended in view of legislative initiatives.

11. Telecommunications and postal services

This sector was covered only to a limited extent in the 1985 white paper. Directives have already been adopted that open up markets in terminals and telecommunication services (e.g. data transmission and e-mail), and another is being formulated to develop a common market for services and equipment goods in satellite communication. Agreement has been reached in principal on liberalization of voice telephony by 1998. The Commission is to report by the beginning of 1996 on the establishment and financing of the universal provision of services which has to be ensured in the liberalized environment. On postal services, the Commission in June 1993 identified some of the key issues, including the definition of the minimum service that must be available to all and what services should be exempt from competition. In December 1993, the Council of Ministers approved a resolution envisaging a common policy that would ensure universal provision of services.

12. Transportation

In aviation, there is greater flexibility in fares and easier access to intra-EU routes and the sector has been made subject to competition rules. Cabotage will become fully liberalized in 1997. As regards road transport, bilateral quotas on transport between member states have been abolished. Cabotage will be extended in stages with full liberalization in 1998. Cabotage has already been introduced for sea transport, though in some areas derogations have been granted until the end of the century.

13. Financial services

The white paper program has been completed providing freedom of cross-border provision of services, based on a single license and home-country supervision. Prudential rules have been harmonized in banking and insurance. Some directives have not as yet entered into force. This will not happen until July 1994 for the new directives on life and non-life insurance, with derogations ranging form 1 to 3 years for Spain, Greece, and Portugal, and 1995 for the directive on investment services.

14. Public procurement

Procurement directives distinguish between supplies, services, and construction projects and between utilities and other public bodies; all directives are already in force except for that related to the supply of services to utilities, which becomes effective in July 1994. With respect to all contracts with utilities, the coming into force of the directives is delayed until 1996-98 in Greece, Portugal and Spain. The directives are effective only above specified monetary thresholds--ECU 5 million for construction contracts, ECU 400-600 thousand for supplies and services contracts with utilities and ECU 125-200 thousand for similar contracts with other public agencies.

Recent Developments in the European Union's Common Agricultural Policy 1/

By driving a wedge between agricultural prices in the EU and in the world market, the common agricultural policy (CAP) has for many years involved significant economic costs and been a source of friction with other major producers even though most of them were also subsidizing their agricultural sectors. Over the years, reforms were introduced to bring the cost of the CAP under control by reining in the growth of production. While these reforms undoubtedly had an impact, they clearly failed to reduce the size of the surpluses. The question at present is whether the reform that was adopted in May 1992 will bring about a decisive change. It certainly represents a departure from the past as support has to a major extent been decoupled from output.

The recent emphasis on the international ramifications of the CAP should not lead to an underestimation of the domestic considerations that have militated in favor of reform. Once self-sufficiency has been attained, as is the case with most of the products covered by the CAP, the budgetary cost of a system that stimulates production by tying support to output cannot but escalate. At a time of fiscal consolidation this makes reform unavoidable. Another factor that is likely to have increased the readiness to reform the CAP is that the weight of the agricultural sector in the economy has shrunk sharply. In 1990, its share in the EU's GDP fell to 3 percent and, with the exodus from the land continuing, its share in employment to about 6 percent.

The present note first gives some background information on the reasons for amending the CAP. This is followed by an outline of the latest reform and a few brief observations on what it is intended to achieve, including in the context of the compromise that has made the conclusion of the Uruguay Round possible. It closes with an explanation of the measures adopted to deal with the impact on agricultural prices of the change in monetary arrangements that have occurred in the EU since September 1992.

1. Background

The objectives adopted for the CAP at its inception were essentially the achievement of self-sufficiency, a fair standard of living for farmers, and "reasonable" prices for consumers.

The CAP was only too successful in the pursuit of self-sufficiency: not only did supply rapidly meet the internal demand for most temperate zone products, but excess production became a problem, not least because of the search for outlets abroad. As emphasized by the Commission in its proposals for the latest reform, the key problem in recent years was that output grew at an average rate of 2 percent a year, while demand increased only by

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1/ Principal contributor: Mr. Rosenblatt (PAR).

½ percent (for an indication of the degree of excess production, see Table 1). 1/

The CAP has not been an efficient instrument for achieving the social objectives set out for the farm sector. As support was until recently linked to output or, in some cases, the capacity to produce, it accrued mainly to the larger, more prosperous farms. Thus, around 80 percent of the support granted through the EU's general budget has accrued to 20 percent of the farms. This largely explains why the exodus from the land continued unabated, with the labor force shrinking by about one-third between 1980 and 1992, and the average size of herds and land holdings increasing further.

From the point of view of consumers, the CAP was not too successful either. The cost they bear is indicated, albeit somewhat roughly, by the "consumer subsidy equivalents" (CSEs), which, when they are negative as in the case of the EU, measure the implicit tax borne by consumers. In 1987-91, *CSEs averaged around 40 percent of the consumption of products* covered by the CAP valued at producer prices. 2/ 3/

The latest reform and its objectives can be understood properly only in the light of how the CAP worked before. Support was granted essentially through minimum prices that applied to the EU as a whole and were subject to an annual review. Two arrangements prevented these prices from being undercut. First, farmers had the option to sell their output to public "intervention" agencies whenever the market weakened. Second, border measures prevented the world market from impinging directly on internal conditions. Specifically, imports were subject to minimum ("threshold") prices somewhat above intervention prices. Depending on whether EU prices were below or above the world market level, export levies or "refunds", ensured that exports fetched the same price as goods sold in the internal market. As prices were generally higher in the EU than in the world market, exports almost invariably qualified for refunds, i.e., subsidies. Finally, so-called monetary compensatory amounts (MCAs), intra-EU levies, and refunds, served to offset temporary price differences among the member states that resulted from realignments and, in the case of countries not adhering to the narrow ERM band of 2.25 percent, exchange rate fluctuations.

1/ For the Commission's considerations and arguments in proposing the reform, see "The Development and Future of the Common Agricultural Policy" in Bulletin of the European Communities, Supplement 5/91, Luxembourg, 1991.

2/ See OECD, Agricultural Policies, Markets and Trade--Monitoring and Outlook 1993, 1993.

3/ One can question, of course, the use of world market prices as the basis for such calculations since they are themselves distorted by the subsidies of the main world producers.

Table 1. European Union: Self-sufficiency in Major Agricultural Products

(In percent of domestic use)

	1980 1/	1985 1/	1990 1/
Cereals	101	110	120 2/
Potatoes	100	101	100 2/
Sugar	135	123	128 2/
Fresh vegetables	102	107	106 3/
Fresh fruit (excl. citrus)	87	87	85 3/
Citrus	72	75	80 3/
Wine	104	104	103
Cheese	106 4/	106	107 2/
Butter	119 4/	110	115 2/
Meat	100 4/	102	102 2/
Oils and fats	57	63	70

Source: Commission of the European Communities, The Agricultural Situation in the Community, various issues.

1/ For the columns "1980" and "1985", the period is a three-year average centered on the year that is indicated; for crop products, it is the marketing year starting in that particular calendar year. For the column "1990", it is the marketing year or the calendar year, depending on the product. Because of insufficient data, the indices do not always refer to the period referred to. This is reported in footnotes only for "1990".
2/ 1989.
3/ 1987.
4/ EU 10.

In the 1980s measures were taken to contain the growth of production. These included quotas for the production of milk and, since 1988, "stabilizers" (ceilings on the volume of output qualifying for support, with overruns penalized by subsequent reductions in the support price) and a budgetary "guideline" according to which the growth rate of budget expenditure related to price support should not exceed 74 percent of the growth rate of the EU's nominal GDP. At the same time, intervention was reduced in scope and made financially less attractive. These measures failed to achieve their objective, chiefly because support prices remained well above the marginal costs of efficient producers.

The total cost of the CAP to consumers and taxpayers in the EU has been estimated with the help of "producer subsidy equivalents" (PSEs), i.e., the sum of price support (including border protection), direct payments, and measures that lower the cost of inputs or benefit farmers indirectly. In the period 1990-92, PSEs averaged some ECU 66 billion a year or close to half of the value of production at farmgate prices. With price support the main tool of agricultural policy, budget outlays of course accounted for only part of total costs. The average annual payments from the EU's general budget, for structural programs as well as price support, were a little above ECU 32 billion in 1990-92. Around one-third of this amount was spent on export refunds.

2. Reform of 1992

Reform became unavoidable because mounting dissatisfaction in the EU with the growth and the structure of the general budget made it imperative to bring expenditure on agriculture under control. A major factor was clearly also the need to accept a reduction in the volume of subsidized exports if the Uruguay Round was to be brought to a successful conclusion. The reform, adopted in May 1992, modifies the support for some major products in a fundamental way so as to give the system greater market orientation; in particular, it decouples, to a large extent, the support for cereals from output. However, it is not so sweeping as to eliminate the mechanisms that have characterized the CAP since its inception. It is only for oilseeds that intervention has been ended and, thus, support has ceased to be open-ended. The success of the reform therefore hinges in large measure on the degree to which the lower level of guaranteed prices will prove an effective incentive in inducing farmers to adjust supply to the desired level of output.

The reform, of which only a very general outline is given below, rests on three ideas. 1/ First, institutional prices are reduced with the aim of eliminating most of the gap vis-à-vis world market prices. Second, the impact of this reduction on income is offset by means of compensatory amounts or premiums that are not related to the volume of production.

1/ For a detailed presentation of the arrangements that now apply see Commission of the European Communities, "The New Regulation of the Agricultural Markets", Green Europe, issue 1/93.

Third, measures are taken to limit productive capacity. At the same time, the traditional instruments of the CAP--intervention and border protection by means of levies and refunds--are retained.

The modifications of the regime for cereals constitute the centerpiece of the reform. It is not just that cereals represent 12-13 percent of the output covered by the CAP (itself around 90 percent of total agricultural production) and account for about one-fifth of the expenditure on agriculture from the Community's general budget. Their prices also have a determining impact on the economics of meat production. The intervention price per ton, which ranged in 1992/93 from ECU 221 for durum wheat to ECU 163 for wheat used as animal feed and coarse grains other than maize, is to be cut in steps to ECU 100 in 1995/96, with the threshold price for imports set at ECU 155 per ton in that year. 1/ Farmers are to be compensated with a flat payment on the basis of the volume of cereals their land can produce, with the area under cultivation at the time of the reform as the maximum and assuming average regional yields. This compensation is to rise to ECU 45 per ton in 1995/96. To qualify, farmers must set aside part of their arable land--15 percent on a rotational basis or, from 1994/95 onward, 20 percent on a fixed basis. Farmers with a production capacity of less than 92 tons are exempt from the set-aside. It is hoped that lower prices will also help attenuate the problem of excess supplies by allowing cereals to retake part of the market for animal feed that was lost to (largely imported) substitutes such as corn gluten.

The changes in the arrangements for beef and veal also aim at discouraging output. The intervention price is being reduced gradually by 15 percent between 1993/94 and 1995/96, and the ceiling on intervention purchases is being lowered from 750,000 tons in 1993 to 350,000 tons in 1997. To the premiums which breeders may claim per animal, new ones have been added that are incentives for early slaughter and reducing the number of animals per hectare of forage area. The main premiums are to rise gradually to a significantly higher level by 1995, but the maximum number of qualifying animals is being reduced sharply, from 3.5 per hectare of forage area in 1993 to 2 in 1996.

A new regime for oilseeds (chiefly rape, sunflower, and soya) was adopted by the Council in December 1991. Starting with 1993/94, there are no longer guaranteed prices and support is granted on a per hectare basis, for a maximum of 5.128 million hectares as of the marketing year 1995/96. The payment per hectare is ECU 359. If the average world market prices for

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1/ In 1995, at ECU 100 per ton, the intervention (minimum) price would be, in nominal terms, similar to the average of the prices recorded in recent years in the world market in the case of wheat and about 20 percent above the average in the case of coarse grains. It should be noted that, in making the above calculation, account was taken of the fact that the intervention price is expressed in the notional "green" ECU at which institutional prices of the CAP are converted into national currencies, and which currently exceeds the market ECU by about 20 percent.

rape, sunflower, and soya differ more than 8 percent from the reference price of ECU 163 per ton, the payment per hectare will be adjusted accordingly. To qualify for payment, the land must be brought under the set-aside scheme that also applies to cereals. The rationale of linking oilseeds and cereals in this way is that farmers tend to alternate between these crops. The new regime conforms with the Memorandum of Understanding on oilseed negotiated with the United States in 1992 and thus settles a long-standing trade dispute, unrelated to the Uruguay Round.

Recent reform efforts have, as yet, touched little on milk and sugar, two other important products with particularly heavy protection and sizable surpluses. In the case of milk, plans envisaged a reduction in quotas by 2 percent over the marketing years 1993/94 and 1994/95, but there has not yet been a decision on implementation. For sugar, the Commission is presently working on proposals. The reform also did not introduce changes for wine, pigmeat, poultry, or fruit and vegetables. However, for pigmeat and poultry, the sharp reduction in the price of cereal feedstuffs is expected to make these products competitive on the world market. Proposals for the wine sector are presently being examined.

3. Expected results

In early 1993, the Commission estimated the reform's likely impact on output and the net balance that would remain in the marketing year 1999/2000 if subsidized exports were limited to the level being negotiated at that juncture under the Uruguay Round. The overall conclusion was that, taking account of this level of subsidized exports, the problem of excess production would largely disappear. In a statement to the press on November 30, 1993, the Commissioner for agriculture stated that the provisional data on the 1993 harvest of cereals suggested that the reform was well on the way of achieving its objective as output totaled 165 million metric tons, slightly less than what had been projected.

The starting point of the simulations, run in early 1993, were two scenarios for cereals that assumed--in addition to the provisions of the reform outlined above--that the reduction in guaranteed prices would cause yields to stabilize at their present level, in the one case, and slow their growth rate to 1 percent a year, in the other. In the first scenario, the initial impact of the reform--reduction in acreage and a cost-induced fall in yields--is consolidated and output stabilizes at its new, lower level. In the second scenario, output almost recovers its pre-reform level by 1999/2000. With consumption continuing to grow at its earlier pace, the surplus of output over domestic demand falls by almost two-thirds in the first case and is cut by about one-third in the second one. In addition, cereals would increase their share of the market for animal feeds, which would further reduce but by no means eliminate the excess of supply over domestic demand.

As a second step in the calculations, the Commission assessed whether the reform could be expected to dovetail with the proposals for reducing the subsidization of exports being negotiated under the Uruguay Round in the sense that sufficient outlets would be left abroad to absorb the remaining excess of supply over domestic demand. In the light of the proposals under discussion at the time of the simulations--and which appear to correspond in the main to the outcome of the Round 1/--the Commission concluded that this would, on the whole, be the case. In particular, excess supply would disappear altogether or become relatively small in the case of cereals. There should also be no difficulty in finding adequate outlets abroad for poultry and pork as the fall in the price of feedgrains should, as noted earlier, make them competitive on the world market (and, hence, not constrained by any ceiling on subsidized exports).

In the beef sector, the net effect of the reform was difficult to judge: consumption should be stimulated by lower prices, but the supply dampening impact of intervention price cuts would be offset in part by the reduced cost of cereals used for animal feed. Overall, while beef production would decline, surpluses were likely to remain relatively large.

Simulations with different models have yielded broadly similar results. However, assessing the degree of realism of these simulations is particularly difficult in view of the very large number of working hypotheses which they require. Guyomard et al., whose simulations of developments in the cereals sector broadly agree with the results obtained by the Commission, spell this out. 2/ They point out that the pass-through of changes in institutional prices may be less than complete, and that farmers may not dissociate fully the direct payments received per hectare from the guaranteed prices for their products. At one extreme, the scenario with perfect pass-through and complete dissociation suggests that the reform could turn the Community into a net importer of cereals. Against that, imperfect pass-through and no decoupling in the minds of the farmers would generate large excess production.

4. Agrimonetary arrangements

The CAP assumes the EU to form a single market, with uniform prices. This requires in principle that institutional agricultural prices, which are set in ECUs for the EU as a whole, be adjusted instantaneously in terms of national currencies after exchange realignments or fluctuations. For each member state, the adjustment should correspond to the change (in percent) in its exchange rate against the ECU, but with the opposite sign. Thus, for

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1/ Under the Blair House agreement, export subsidies are to be reduced by 36 percent from their 1986-90 level by the year 2000, while the volume of subsidized exports is reduced by 21 percent. Except for the size of the annual installments, this is what has been negotiated for the industrial countries. See Article 2(b)(iv) of the Agreement on Agriculture that is part of the Final Act Embodying the Results of the Uruguay Round.

2/ H. Guyomard, C. Le Mouël, Y. Surry, "Les effets de la réforme de la PAC sur les marchés céréaliers communautaires. Analyse exploratoire." in Cahiers d'Economie et Sociologie Rurales, INRA, No 27, 2nd quarter 1993, pp.7-41.

instance, a revaluation calls for a reduction of prices in national currency terms. As adjustment may in many cases pose problems, the extent to which it may be delayed and how this should be done has been an issue since the early 1970s.

For many years, delays in adjustment were made technically possible by temporary resort to so-called monetary compensatory amounts (MCAs). These amounted to export subsidies and import levies for revalued currencies and, correspondingly, to import subsidies and export levies for devalued currencies. MCAs proved costly to the EU's budget and not entirely effective in preventing trade distortion within the EU. Over time, the MCA system therefore underwent some modifications with a view to limiting its importance. As an extension of the rule of no adjustment in institutional prices for fluctuations within the narrow ERM band, a "neutral margin" was created within which exchange rate movements do not call for price adjustment. The size of this margin varied not only between strong and weak currencies but, to some extent, also among products.

On a number of occasions, the level of institutional prices was raised in order to spare countries with appreciated central parities the need to lower these prices in terms of their own national currencies. This procedure, known as the "switchover mechanism", amounts to raising the EU level of institutional prices toward the level prevailing in a country with an appreciated currency. In a formal sense, the switchover mechanism is applied by revaluing the green ECU (in which the institutional prices are expressed) against the currencies of the member states. In individual countries, depending on whether their exchange rate has appreciated or depreciated against the market ECU, this measure reduces the extent to which prices (in domestic currency) have to be lowered or sets a new level to which prices will eventually have to rise. The set of agricultural conversion rates resulting from application of the switchover mechanism became known as the "green" ECU.

MCAs were abolished as of January 1, 1993, as part of the completion of the internal market. In the first half of 1993, there were significant exchange rate movements, with depreciations of the central parities of the Irish pound, the Portuguese escudo and the Spanish peseta. Farmers in countries appreciating against the ECU were sheltered as resort was taken to the switchover mechanism and the "green" ECU was revalued by an additional 1 percent.

A new situation arose with the widening of the ERM band to 15 percent on August 2, 1993 as this meant, for the purpose of the agrimonetary arrangements, that the currencies of all member states were effectively floating. This prompted Germany to propose that institutional prices be raised pari passu with the appreciation of the strongest currency, which would have amounted to automatic resort to what was referred to earlier as the switchover mechanism. 1/ However, it was agreed that it would be undesirable to allow the common price level to rise at this time. Besides increasing the budgetary cost of the CAP, it would run counter to the objective of aligning the price level as closely as possible with the world market that is a central element of the latest reform. To reduce the need to adjust prices and to ease the burden on the budget, new neutral margins were adopted: 3 percent for appreciated currencies and 2 percent for depreciated currencies. To allow for some flexibility in the management of the system, the Commission may shift this five-percent range upward as far as 5 percent for appreciated currencies, which leaves no neutral margin for depreciated currencies. Thus, it will be possible to avoid resorting to increases in the EU level of institutional prices (which requires a decision by the Council) in the case of an appreciation up to 5 percent. Furthermore, the provisions for temporary assistance to farmers facing price reductions that are cofinanced by the Community were amended so as to withhold assistance in cases where the appreciation of the exchange rate is short-lived.

These developments do not mean that the agrimonetary arrangements have ceased to be an issue. As agreed in 1992, they will have to be re-examined before the end of 1994. Further, if exchange rate fluctuations were so strong as to cause the neutral margin to be exceeded, the resulting additional expenditure would pose a problem as it would have to be accommodated within the appropriations voted for in the CAP.

1/ Formally, the switchover mechanism depends on changes in central parities.

Europe Agreements 1/

I. Introduction

In December 1991, the European Union (EU) signed Association Agreements (or "Europe Agreements") with the governments of Hungary, Poland, and Czechoslovakia. The agreement with Czechoslovakia was replaced by two separate agreements with the Czech Republic and Slovakia in October 1993, and similar agreements were concluded with Romania and Bulgaria in February and March 1993. These agreements can be considered as one of the notable achievements connected with the ending of the cold war in Europe and the beginning of a new era of closer political, cultural, and economic cooperation between the countries of eastern and western Europe. The political and cultural significance of the agreements is duly reflected in the preambles, which expressly refer to the common values shared by the signatory parties, their commitment to strengthening political and economic freedom, and the full implementation of all provisions and principles of the Conference on Security and Cooperation in Europe.

Equally important, the agreements form the basis for the progressive economic integration of eastern European countries with the EU. They contain provisions covering a wide range of economic and financial issues: liberalization of international trade in goods and services, the movement of capital and labor, the right of establishment according to the principle of national treatment, rules with regard to competition, and the harmonization of economic and financial laws to EU legislation. 2/ The agreements are concluded with a view to the ultimate aim of the signatory countries to become full EU members as agreed by the European Council at the Copenhagen Summit in June 1993.

This annex mainly focuses on the trade liberalizing aspects of the agreements. The integration of the association countries into the multilateral trade system requires more secure and comprehensive access to western markets as well as sustained efforts in implementing domestic reforms. By liberalizing trade between the EU and the association countries, the Europe Agreements play an important role in the reorientation of trade relations. Section II contains a brief analysis of recent trends in trade between the EU and the signatory countries, and section III focuses on the most important provisions on trade in the agreements. Finally, section IV gives a brief overview of the other major areas covered by the agreements.

1/ Principal contributor: Mr. Harmsen (PDR).

2/ In addition, the accords include articles on political dialogue and economic, financial, and cultural cooperation. There are three Protocols on trade in clothing and textiles, coal and steel, and agricultural products, and two Protocols on rules of origin and trade between the association countries and Spain and Portugal.

II. Recent Trends in Trade

Until 1989, a large part of foreign trade of eastern European countries accounted for trade with other centrally planned economies within the Council for Mutual Economic Assistance (CMEA) and was conducted in nonconvertible currencies on the basis of five year bilateral arrangements. Before 1989, between 60 to 70 percent of Bulgarian, Czechoslovak, and Romanian exports, and 40 to 50 percent of Hungarian and Polish exports went to CMEA countries. The commodity composition of trade differed between socialist and market economies. Exports of machinery and transport equipment were the most important exports to socialist countries compared to exports of food, crude materials, and light manufactured items to the developed market economies. Since 1989, and to a lesser extent also in the years before, there has been an important shift in the trade patterns of these countries; a shift that has been accelerated following the abandonment of the CMEA trading arrangements in early 1991 and the dissolution of the Soviet Union. The importance of developing and industrial countries, in particular the EU, in both exports and imports has increased in absolute and relative terms while that of the transition countries has declined considerably. The share of exports to the (former) CMEA has fallen by 50 percent or more between 1988 and 1992 for most association countries while the share of exports to the EU has more than doubled during the same period. Similar trends hold on the import side (see Tables 2 and 3). A clear exception is Romania, where exports to industrial countries fell until 1991 as a result of increasing domestic supply constraints, and where the shift in the geographical composition of exports is less marked.

Growth has been visible in all major categories of association country exports to the EU, except for mineral fuels. A sharp decline in the share of the latter (see Table 4) reflects limits on the market access of coal exports from Poland and Czechoslovakia. The share of agricultural exports also declined significantly, although they still grew in value terms. Data for 1992 exaggerate somewhat the relative weakness of agricultural exports owing to drought conditions in that year.

In the first years of the transition period, the strong growth of trade with the EU likely was predominantly a reflection of the reorientation of traditional domestic producers towards western markets. Many state-owned industries were facing declining export orders from eastern Europe as a result of the collapse of the old trading links with their CMEA partners. Furthermore, the abolition of the central command system and the transition to market oriented economies led to a sharp decline in domestic production and demand. These circumstances forced the industries of east European countries to look for new markets for their products, and they found them in the west. Trade with western Europe seems to have been further stimulated by the emergence of new, export oriented small and medium-sized enterprises. Many of these enterprises were created in the context of the privatization or restitution to their previous owners of former state enterprises. Others are entirely new ventures. However, precise data on the growth of private sector activity is not available.

Table 2. Developments in the Trade of Central and East European Countries with the European Union, EFTA, the United States, Japan, and Canada between 1989 and 1992 1/

(Cumulative percentage changes, in terms of U.S. dollars)

	Exports to:	Imports from:
European Union	+ 83	+ 120
EFTA countries	+ 39	+ 87
United States	- 9	+ 84
Japan	- 18	+ 23
Canada	- 37	+ 73

Source: European Commission.

1/ Includes trade with association countries and Albania.

Table 3. Association Countries: Trade Composition by Partners 1/

(In percent)

	1988	1989	1990	1991	1992
Total exports (in millions of US dollars)	51,523	47,992	40,942	39,974	41,541
Transition countries	50.9	48.5	36.7	26.1	22.3
of which:					
former CMEA	46.2	43.6	34.1	22.6	19.3
Other	49.1	51.5	63.3	73.9	77.7
of which:					
EU	21.9	25.0	35.0	46.5	49.5
Total imports (in millions of US dollars)	45,063	41,967	39,629	40,120	48,067
Transition countries	54.8	52.5	40.9	27.7	24.0
of which:					
former CMEA	49.4	46.8	36.6	25.8	22.6
Other	45.2	47.5	59.1	72.3	76.0
of which					
EU	18.9	23.6	36.6	42.4	45.9

Source: IMF, Direction of Trade.

1/ Excluding Bulgaria.

Table 4. Trade Between the European Union and Association Countries

(in percent of total)

	Commodity	1988	1989	1990	1991	1992
	Exports of Association Countries					
0	Food and live animals	13.6	15.1	15.0	13.6	10.4
1	Beverages and tobacco	0.6	0.6	0.7	0.7	0.7
2	Crude materials	9.3	8.9	8.3	7.5	7.4
3	Mineral fuels	12.4	13.1	8.7	6.3	4.0
4	Animal, vegetable oil, fat	0.2	0.2	0.1	0.2	0.2
5	Chemicals	8.4	8.1	9.1	9.4	8.0
6	Basic manufactures	22.9	22.7	24.6	24.7	27.4
7	Machines, transport equip.	11.6	11.2	12.2	14.7	16.2
8	Misc. manufactured goods	19.7	18.7	20.2	21.7	24.2
9	Good not classd. by kind	1.2	1.3	1.2	1.3	1.4
	Total	100.0	100.0	100.0	100.0	100.0
	Imports of Association Countries					
0	Food and live animals	6.0	8.9	8.0	7.5	6.6
1	Beverages and tobacco	0.7	1.1	1.4	1.8	1.4
2	Crude materials	4.7	3.9	3.5	2.7	2.4
3	Mineral fuels	0.7	0.6	1.8	3.0	3.5
4	Animal, vegetable oil, fat	0.3	0.4	0.4	0.4	0.5
5	Chemicals	22.0	17.9	14.7	12.2	11.8
6	Basic manufactures	20.6	20.3	19.8	18.4	19.9
7	Machines, transport equip.	35.1	36.5	38.3	41.2	40.5
8	Misc. manufactured goods	8.6	8.9	10.5	11.3	12.2
9	Goods not classd. by kind	1.3	1.5	1.8	1.6	1.3
	Total	100.0	100.0	100.0	100.0	100.0

Source: World Bank, Trade Analysis and Reporting System.

III. Europe Agreements

Trade growth has been facilitated by progressive liberalization of international trade between the EU and east European countries. Bilateral trade and cooperation agreements were concluded with Hungary in September 1988, Poland in September 1989, Czechoslovakia and Bulgaria in May 1990, and with Romania in October of the same year. These cooperation agreements provided for MFN treatment and the phasing out of all selective quantitative restrictions (QRs) over a ten-year period. 1/ The EU granted GSP status to Poland and Hungary in January 1990, and to Czechoslovakia and Bulgaria in January 1991. Romania had already been granted GSP status in 1974. The Europe Agreements form the latest initiative directed towards trade liberalization. Anticipating formal ratification, the trade arrangements became effective on the basis of interim agreements in March 1992 for Czechoslovakia, Hungary and Poland, and in May and December 1993 for Romania and Bulgaria. The agreements contain provisions for immediate or progressive trade liberalization between the association countries and the EU, with separate protocols for agricultural products, clothing and textiles, steel, and coal. The reference rates for duties and QRs to which the concessions applied, were those prevailing on the day before the operation of the agreement. The scope and pace of these concessions vary across sectors and product categories and their implementation is generally asymmetric in that the EU will introduce most concessions before the association countries. Moreover, in June 1993 the European Council adopted a proposal of the Commission according to which the trade liberalization measures agreed upon at an earlier stage were speeded up considerably.

1. Liberalization of trade in industrial products (general)

Most tariffs and all QRs still imposed by the EU on general industrial goods (excluding sensitive products) were eliminated immediately after the agreements entered into force. All duties (including tariff quotas and ceilings) are being eliminated within the first three years of the agreements. Association country concessions involved the immediate removal of QRs on almost all industrial imports from the EU and gradual duty reductions and elimination of QRs on most of the remaining products (such as automobiles) during or at the end of the ten year transition period. The extent of these duty reductions and the pace of liberalization by both sides are summarized in Table 5.

1/ In 1992 and 1993, agreements were also signed with EFTA which are aimed at gradually establishing a free trade area between the EFTA and the association countries over a ten-year transition period during which EFTA will reduce tariffs more rapidly than the eastern European countries.

Table 5. Association Agreements: Summary of Concessions, General

Product	Immediate	1-5 Years	5-10 Years	Comments
General Industrial Products EU	Imports (a) Eliminate duties on all Group 1 industrial imports, (chemical products, leather products, wooden products, household appliances, and industrial machinery). (b) Abolish all QRs on products in (a).	Imports (a) Progressive duty reductions for Annex 2a (mineral products, inorganic chemical products, ferro-alloys, etc.) and 2b products (zinc, aluminum, ferro-silicum). (i) Reduce import duties by 50 percent on entry into force of Agreements and eliminate duties in second year of Agreements for Annex 2a products. (ii) Eliminate duties within three years for Annex 2b products. (b) Increase tariff quotas and ceilings for Annex 3 products (including cement, organic and inorganic chemical products, leather products, glass products, automobiles, etc.) by 30 percent per year. Reduce import duties to zero after three years.		General industrial product provisions do not apply to excluded products (some industrial raw materials) and protocol sector goods. EU may retain agricultural component of duty on industrial imports and Association countries may re-introduce agricultural component of duty on industrial imports from the EU. Both sides agree to remove barriers more rapidly if possible.

Table 5. (concluded) Association Agreements: Summary of Concessions, General

Product	Immediate	1-5 Years	5-10 Years	Comments
General Industrial Products Association Countries	Imports (a) Abolish duties on raw materials, semi-products, some investment goods. (b) Abolish QRs on all general industrial imports except for Annex 5 products (some chemical products, pharmaceutical products, and telecommunication equipment).	Imports (a) Reduce duties to two-thirds of basic duty for Annex 4a products (various chemicals, metals, acids, machinery equipment for manufacturing, etc.). Reduce to one-third of basic duty by Jan. 1, 1993 and completely eliminate duties by Jan. 1, 1994. (b) Poland - Abolish import licenses on petroleum oils, crude oils, and petroleum products by end of fifth year.	Imports (a) Reduce duty for Annex 4b products (fertilizers, leather goods, paper and rubber products, and motorvehicles) to 90 percent of basic duty in 1995 followed by annual reductions of 15 percent. Eliminate all duties by 2001. Poland - In 1995, reduce duties to 80 percent of the basic duty on all other industrial imports (not in Annex 4a and 4b) followed by annual reductions of 20 percent until duties completely eliminated by 2000 at latest. Hungary - Reduce duties on all other industrial imports (not included in 4a and 4b) by one-third of basic duty per year between 1995 and 1997. (b) Poland - Abolish QRs on auto and autobody imports, motorvehicles, and auto engines by end of tenth year. (b) Hungary - Starting 1994, abolish QRs on up to 40 percent of EC exports to Hungary covered by Annex 5 (some chemical products, passenger cars, furniture, pharmaceutical products). Eliminate the rest of the QRs between 1998 and 2000. Starting in 1993, Hungary will raise quantitative ceilings for products like passenger cars, household chemicals, and furniture in Annex 5 by 10 percent every year until QRs are completely eliminated.	

2. Liberalization of trade in clothing and textiles, coal and steel, and agricultural products

Trade in clothing and textiles, coal and steel, and agricultural products are subject to special protocols which are in general more restrictive (see Tables 6 to 8). All three protocols have been framed to a large extent in the context of existing international arrangements, which limit the scope and nature of trade liberalization in these sectors.

The EU has granted tariff concessions to association countries by immediately abolishing duties on re-imports of textiles and clothing and gradually eliminating remaining duties in five years. QRs will be phased out in a five year period. In 1992, exports of these products constituted on average about 12½ percent of total exports of manufactured goods of the association countries to the EU. Association country concessions consist of immediate removal of QRs and progressive elimination of duties on textiles and clothing imports from the EU.

Under the agreements, the contracting parties immediately abolished QRs on steel imports. Duties will be phased out in three to four years. Association country exporters are subject to ECSC pricing, competition, and subsidy rules. Reflecting the significance of heavy industry in most east European countries, steel and metallurgical products accounted on average for 4½ percent of association country exports of manufactured goods to the EU in 1992 and as much as 11½ percent for Czechoslovakia. The EU eliminated QRs on coal imports one year after the entry into force of the agreements, with the exception of some coal products. Duties will be phased out at the end of 1995. Germany and Spain are allowed to maintain national QRs for a period of five years after the entry into force of the agreements.

The significance of the agricultural sector in association countries differs considerably, which is reflected in the structure of exports. Exports of agricultural products as a share of total exports to the EU varied between 6 percent for Czechoslovakia to 21½ percent for Hungary (1990-1992). On average, 14 percent of association country exports to the EU consisted of agricultural products. All concessions on agricultural products are phased and involve levy reductions or tariff quota concessions, primarily in the first three to five years of the agreements. Some important groups of commodities, in particular cereals, are excluded from liberalization.

EU concessions are provided within the structure of the CAP. Products such as beef, pork meat, mutton, poultry, and dairy products will be subject to reductions in import charges of 20 percent over three years. EU equalization charges on young cattle will be reduced by 75 percent, and import quotas will be increased by 10 percent per year after the entry into force of the agreements. Fruits and vegetables will be subject to differentiated customs duty reductions, and import quotas will be increased by 10 percent per year over a five-year period. Custom duties on milk will be reduced by 20 percent per year in three consecutive years.

Table 6. Association Agreements: Summary of Concessions, Textiles and Clothing

Protocol Sectors	Immediate	Phased	Comments
<u>Textiles and Clothing</u>	<u>Imports</u>	<u>Imports</u>	EU concessions also include increases in import levels and growth rates, flexibility for quantity limits, and elimination of certain quantity restrictions.
EU	(a) Eliminate duties on re-imports of textiles and clothing from Association countries. No immediate elimination of duties on remaining textile and clothing imports. (b) No immediate QR reductions by EU.	(a) On entry into force of Agreements, reduce duties on textiles and clothing imports until duties completely eliminated by beginning of 1997. (b) Phasing out of QRs in five-year period. Gradual elimination of duties in five-year period.	
Association Countries	(a) No immediate duty elimination. (b) Abolish all QRs and equivalents (not binding) upon entry into force of Agreements	Eliminate duties on textile and clothing imports from EU progressively.	

Table 7. Association Agreements: Summary of Concessions, Steel and Coal

Protocol Sectors	Immediate	Phased	Comments
ECSC Products EU	Imports (a) No immediate tariff elimination on coal and steel imports. (b) Abolish QRs and equivalent measures on steel imports from Association countries, with some exceptions.	(a) Reduce duties on steel imports from Association countries by 30 percent per year from base rate of about 5 percent. Reduce duties on coal imports to 50 percent of basic duty in 1994 and to 0 by the end of 1995. (b) Abolish QRs on coal imports at latest one year after the Agreements into effect and in five years for Germany and Spain.	ECSC rules on competition policies and state subsidies applicable under Agreements. In the first five years, Association countries may provide public aid to domestic steel producers for restructuring but within limits. Either side may use safeguard measures if threat of injury.
Association Countries	(a) No immediate duty reductions. (b) Abolish QRs on steel and coal imports upon entry into force of Agreements.	Reduce duties on steel imports from EU by 20 percent per year until completely eliminated by the beginning of the sixth year.	

Table 8. Association Agreements: Summary of Concessions, Agriculture

Protocol Sectors	Immediate	Phased	Comments
<u>Agricultural Products</u>	<u>Imports</u>	<u>Imports</u>	
EU	No immediate tariff or nontariff barrier elimination by EU.	Since all the concessions are phased, they are presented by product groups differentiated by the type of concessions involved. For <u>Group 1</u> products (ducks, geese, potato starch, and pork), upon entry into force of Agreements, equalization charges to be reduced by 50 percent for specified import quotas. Import quotas on these products to be increased by 10 percent per year over initial base over a five-year period. For <u>Group 2</u> products (wild game, honey, onions, etc.) reduce duties by 30 to 100 percent over 5 years and eliminate all imports quotas on these products over the same period. System of minimum prices to be maintained for selected fruits in this list. For <u>Group 3</u> products (young cattle) reduce equalization charges on young cattle by 75 percent and increase import quotas by 10 percent per year starting 1992. If the number of animals imported from all sources is below EC's reference quantity, then a global tariff quota equalling this deficit will be opened to imports from the Association countries. Animals entering the EC within this quota will face 25 percent of the full levy. If imports of these products exceed a specified quantity (425,000) and serious disturbance is caused in the EC market, safeguard measures can be taken. Reduce import charges on beef, pork meat, mutton, poultry, and dairy products by 20 percent per year in three consecutive years. Increase import quotas by 10 percent per year over five years.	Both sides to hold periodic consultations in view of CAP and GATT developments. Association Council can extend the list of products subject to Protocol or increase amounts benefitting from tariff concessions. Duty reductions apply within limits of tariff quotas specified in Agreements; for quantities exceeding these limits, duty rates to non-preferred third countries applicable. Under minimum price requirement within certain time period, average unit value of product imported into EU cannot be less than its minimum price under CAP. If this requirement is not met, EU can introduce measures to see minimum price met.

Table 8. (concluded) Association Agreements: Summary of Concessions, Agriculture

Protocol Sectors	Immediate	Phased	Comments
Agricultural Products EU		For Group 5 products (most fruits and vegetables, dried fruits, fruit products), a differentiated ratio of customs duty reductions will be applied. Increase import quotas by 10 percent each year. For Group 6 products (processed agricultural products), customs duties will be reduced for milk by 20 percent per year and by 10 percent for other products (sugar, flour, etc.) in three consecutive years. Most concessions phased in over five years and involve tariff reductions and quota increases.	Safeguard provisions can be applied if threatened by increased imports in either party. Triangular assistance methods included in Protocol. The triangular operations refer to the use of Association country agricultural exports to the EU by the latters in supplying aid to Russia. Agreements specify that Association country exports benefitting from such operations will be deducted from their quota allocations in the EU.
Association Countries	Little upfront elimination of tariff or nontariff restrictions. Duty reductions of 10 or 15 percent on some products in the first year and some quota increases.	Abolish QRs on imports of products like oils, extracts, tea, vegetable extracts over a five-year period. Increase number of products in this list over the five years, which are currently subject to QRs. Reduce duties on various poultry products, grain products, and cheeses, etc. by 10 percent per year in three consecutive years. Duty reductions on some products like vegetable oils of 15 percent per year in three consecutive years. Both groups of products to receive quota increases over the period.	

Association countries will provide duty reductions of 10 or 15 percent in the first year with some quota increases. QRs on oils, tea, and vegetable extracts will be phased out over a five-year period, and duties on poultry, grain products, and cheese will be reduced by 10 percent per year over a three-year period. The association countries agreed to eliminate QRs on an increasing number of products over the five years.

3. Safeguards and balance of payments provisions

The Europe Agreements contain several safeguards and balance of payments provisions. They allow for an increase in duties in the association countries to protect infant industries or industries undergoing restructuring and facing important social problems. Furthermore, both parties can introduce antidumping actions in accordance with Article VI of GATT. In addition, they may take measures if growth of imports causes or threatens to cause serious injury to domestic producers, or serious disturbances in any economic sector. The agreements also include the option, for association countries, of restrictive measures for balance of payments reasons, and the introduction of limits to exports (i.e., in the case of domestic shortages). Finally, measures may be taken to compensate for anti-competitive practices or subsidies.

The Europe Agreements are generally in line with existing GATT rules in this field, though they provide for greater flexibility and seem to leave some room for additional measures not explicitly covered by the GATT. The option for association countries to increase (without compensation) tariffs on imports from the EU to protect industries facing serious social difficulties is not offered by the GATT, in so far as these tariffs are bound under the GATT. Furthermore, the safeguard clause with respect to specific imports is easier to apply than the corresponding article in the GATT (Article XIX). While the GATT offers the option to take protective measures in case of increased imports and injury to domestic producers, under the Europe Agreements measures may be taken if only one of these conditions is met.

Since March 1992, when the first agreements became effective, signatory countries have introduced several restrictive measures on the basis of the safeguard and balance of payments clauses. In August 1992, the EU introduced QRs on certain steel imports from Czechoslovakia with the aim to limit imports to 20 percent above the level attained in 1991. These measures came after a period of strong growth of sales of steel from Czechoslovakia on EU markets. In May 1993, the Czech and Slovak Republics agreed to separate export quotas for the period 1993-95. 1/ In November 1992, the EU imposed provisional antidumping duties on imports of

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1/ The agreement covers five specific products: cold-rolled sheet, wire rod, hot-rolled strip and hoop, seamless tubes, and welded tubes. In 1992, the value of Czechoslovak exports of these products to the EU reached 237 million ECU, about one quarter of total Czechoslovak exports to the EU of base metals and products.

seamless steel tubes from Czechoslovakia, and definitive antidumping duties on imports of seamless steel tubes from Croatia, Hungary, and Poland. 1/ In December of the same year, Poland introduced a general import surcharge of 6 percent under the balance of payments provisions of the agreement. Finally, the EU imposed temporary import restrictions on agricultural products from the Czech Republic and Hungary in 1993, and opened antidumping proceedings with respect to imports of cement from the Czech Republic, Poland, and Slovakia in May 1994.

IV. Integration in Other Areas

The Europe Agreements also provide for a framework for integration between the EU and the association countries in other areas of common interest, reflecting the significance of the agreements as a first step towards full membership. The agreements contain provisions on political, cultural, economic, and financial cooperation, the movement of workers, the right of establishment, trade in services, payments and financial transfers, competition rules, property rights, and the approximation of law.

Political cooperation is embedded in a framework for regular political dialogue between the EU and the association countries. This will allow the participants to discuss all matters of common interest with the aim of supporting the political and economic changes in the association countries and increasing convergence of positions on international issues. The section on cultural cooperation provides for the possibility to extend EU cultural cooperation programs (or those of the member states) to the association countries, and it is agreed that new actions of mutual interest will be developed.

Economic and financial cooperation is aimed at contributing to the association countries' development and at strengthening their competitiveness. It covers, inter alia, industrial cooperation, investment promotion and protection, technical product standards, science and technology, education and training, agriculture, energy (including the nuclear sector), the environment, transport, telecommunications, financial services, and direct financial assistance in the context of PHARE and EIB loans. Financial assistance may also include general macroeconomic support.

The provisions on the movement of workers primarily aim at creating certain standards with respect to the treatment of workers employed abroad. The access to national labor markets, however, remains subject to the legislation of individual member states. The agreements also contain provisions on the national treatment of existing and new foreign establishments of enterprises (including self-employed persons). The EU granted national treatment upon entry into force of the agreements, whereas

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1/ As the antidumping investigation was initiated before the entry into force of the Interim Agreements, this measure was based on the preceding trade and cooperation agreements.

transitional periods were foreseen for the association countries. The supply of services is not yet fully liberalized, but the parties have agreed on progressive opening up of markets. The agreements also provide for the mutual obligation to authorize payments in convertible currencies related to the movement of goods, services or persons, and financial transfers related to direct investments, including the repatriation of capital and profits.

As concerns competition law, the association countries have undertaken to adopt the principles of competition rules on the basis of the criteria arising from the application of articles 85, 86, and 92 of the Treaty of Rome, which cover anticompetitive business practices and state aids. For the purposes of applying the EU's rules on state aids, public aids granted by the association countries will be assessed taking into account the fact that they will be considered as areas where the standard of living is abnormally low. Under EU law, such aids may be deemed to be compatible with the internal market. This provision will be reconsidered after a period of five years. The association countries have also undertaken to adopt within five years from the entry into force of the agreements levels of protection of intellectual, industrial, and commercial property in line with EU legislation. Finally, with a view to their economic integration into the EU, the association countries will bring existing and future legislation in certain key areas into line with EU legislation. This includes customs law, company law, company accounts and taxes, intellectual property, protection of workers at the workplace, financial services, rules on competition, protection of health and life of humans, animals, and plants, consumer protection, indirect taxation, technical rules and standards, transport, and the environment.