AN ANALYSIS OF THE IMPACT OF WEST EUROPEAN INTEGRATION
ON DEVELOPING COUNTRIES – WITH SPECIAL
REFERENCE TO PAKISTAN

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I. INTRODUCTION

Western Europe has been a centre of trade and commerce for
centuries. The area is of special importance for underdeveloped
countries both as a source of imports and as a market for their
exports. The establishment of the EEC and the EFTA was, therefore,
not hailed by the less developed countries. They feared that a
substantial portion of their exports may be eroded or displaced by the
members of these groups. Most of these less developed countries were
already suffering from chronic deficits in their balance-of-payments
and the situation was expected to worsen after these institutional
changes in Western Europe. This had important implications not only
for trade but also for the development strategies in many countries.

It is well known that the balance-of-payments gap put severe
limits to the growth prospects of LDCs. Because of the highly needed
capital imports, the problem of economic growth in the initial stages
boils down to a consistent softening of the foreign exchange constraint.
This can be achieved by increasing foreign exchange earnings and/or foreign
exchange transfers. The foreign exchange transfers can take the form
of foreign economic assistance and foreign investment. Now, it is well
known that the developed countries have failed to fulfill the aid
requirements of developing countries. The aid that did flow to LDCs
has mostly been tied. The terms have become much more tight and the
'grant element' of loans has decreased. As regards foreign investment,
the politico-economic conditions obtaining in LDCs limit its scope in
spite of the lucrative inducements offered by some of these countries.

The gloomy prospects for foreign exchange transfers, the
political strings attached to foreign loans and the feeling of self-
respect on the part of LDCs have all combined to result in the slogan,
"trade not aid'. In the last two decades, the less developed countries
have placed much more importance on obtaining more favourable trade
openings than on aid. West European integration came as a blow to their
efforts. If the developed countries are serious in their intention
to help the less developed countries to grow, then they have to ensure
better export prospects for the LDCs. Western Europe has a significant
role to play in this regard since the area is of prime importance as an
export market to most of the less developed countries. This study
analyses how far the degree of protection in Western Europe has been
intensified due to the formation of EEC and EFTA and the extent of loss
that it has caused for the exports of developing countries.

2. PLAN OF THE STUDY

In the next section we document the importance of Western
Europe as an import market. In section four the question of the inci-
dence of the Common External Tariff (CET) of the EEC is taken up.
While the EFTA simply removed tariff barriers on intra-area trade, the
EEC also required the members to establish a common tariff against
outsiders. The issue at hand is whether or not the CET is higher than
the national tariffs that it replaced. Apart from this question, since
the members would face no restrictions in trade with each other, the
imposition of any tariff on non-members introduces an element of
discrimination against outsiders. Thus, for some goods any Common
External Tariff, however, low it may be, represents an increase in the

effective protection against the non-members. This is the subject of
section five. The 'rate of discrimination' is calculated using Pakistan
as a case study. Finally, the preposition that even though the forma-
tion of customs union may harm outsiders in the short run, over a
longer period it will benefit all countries due to dynamic effects
and external trade creation, is examined. In this regard, the import
performance of the EEC and EFTA is reviewed in section six. A regression
model is employed to establish the net effect of these blocs on less
developed countries. The last section gives summary and conclusions.

3. WESTERN EUROPE AS AN IMPORT MARKET

The importance of Western Europe in World trade can hardly be
exaggerated. Because of its central location, its leading role in the
industrial revolution, its comprehensive transportation network and
perhaps most important, because of the colonial ties with a large number
of countries which accommodate a large percentage of world population,
Europe has been the pivot of trade and commerce for centuries. For less
developed countries its importance is overwhelming, both as the origin
of their imports and as the destination of their exports.

Western Europe is in general more dependent on foreign trade
than other industrial countries. As shown in Table I, the four big
West European countries France, West Germany, Italy and the United Kingdom
all depend on foreign trade to the extent of 15-20 per cent of their
gross domestic products. The smaller countries are even more dependent
on foreign trade. In both Belgium - Luxemburg and the Netherlands,
foreign trade is equal to around 40-45 per cent of the GDP. In the
Scandinavian countries the proportion is roughly 25-30 per cent. As

Table - I

Foreign Trade[a] as Percentage of GDP

Countries	1970	1975
Austria	22.0	22.48
Australia	14.7	13.5
Belgium/Luxemburg	44.7	47.45
Canada	18.7	21.24
Denmark	24.9	26.93
France	12.8	15.95
Germany F.R	17.0	18.09
Greece	13. 6	18.31
Ireland	34.8	44.89
Italy	15.2	20.94
Japan	8.7	11.57
Netherlands	41.6	42.74
New Zealand	19.6	19.75
Norway	27.5	29.90
Portugal	20.3	19.50
Spain	11.0	11.62
Sweden	20.9	25.48
Switzerland	27.5	24.19
Turkey	5.8	8.58
United Kingdom	16.8	21.49
United States	4.4	6.93

Source: International Financial Statistics, May 1978

a) Average of exports and imports.

compared to these, the proportion for the United States and Japan are roughly 5 and 10 per cent respectively.

The total imports of the area in current prices were 375.2 billion dollars in 1975 which accounted for 43.0 per cent of total world exports. The regional distribution of West European trade presented in Table 2 reveals that even though the region takes a considerable proportion of the exports of industrial countries outside the regions, as a market it is much more important to developing countries. The developing countries exported 35.6 per cent of their total exports to Western Europe as compared to 24.1 per cent for North America and 14.5 per cent for Japan. However, the most significant links exist within the two trading circuits i.e., the EEC and the EFTA. The intra-trade of these blocs was 44.7 and 27.5 per cent of their respective trade. Viewed as one region, the intra-trade of Western Europe accounted for 64.3 per cent of region's trade.

The importance of the West European market will obviously be different for different countries. It is not possible to dicuss all developing countries separately. Here we analyse the case of Pakistan.

Table 3 gives the principal exports of Pakistan to its major trading partners. A number of points are worth mentioning. First it may be noted that both the EEC and the EFTA are important markets for Pakistan's exports, jointly accounting for more than 25 per cent of its exports. The EEC is the single largest market, followed by the U.K. and the U.S.A. Second, in six out of the eleven categories, Western Europe imports more than 30 per cent of Pakistan's exports: in two of them-leather and floor coverings and tapestry-about 70 per cent, and in another -- sporting goods -- more than one-half. Third, interestingly

Table 2

Regional Distribution of West European Trade (1975)

| Exports to | World | | Western Europe | | | | | | | |
| | | | Total | | E E C | | EFTA Total | | U. K. | |
Exports from	Value	Per-cent-age [a]	Value	Per-cen-tage	Value	Per-cen-tage	Value	Per-cen-tage	Value	Per-cen-tage
World	872,530	100.0	375,250	43.0	224,790	25.8	116.930	13.4	48,020	5.5
Western Europe(total)	362,350	100.0	233,170	64.3	140,650	38.8	75,000	20.7	24,330	6.7
EEC	240,170	100.00	160,950	67.0	107,320	44.7	42,460	17.7	14,110	5.9
EFTA(total)	105.040	100.0	62,690	59.7	27,840	26.2	28,930	27.5	7,690	7.3
U.K.	47,760	100.0	20,870	47.7	11.070	25.3	6,500	14.8	–	–
U.S.A.	106,160	100.0	28,800	27.1	17,380	16.4	8,190	7.7	4,390	4.1
Canada	32,300	100.0	4,630	14.3	2,230	6.9	2,180	6.7	1,750	5.4
Japan	55,750	100.0	8,080	14.5	3,930	7.0	3,250	5.8	1,470	2.6
Developing Countries	210,010	100.0	74,820	35.6	48,630	23.2	18,310	8.7	11,920	5.7

a
Percentage by Origin

Source: handbook of International Trade and Development Statistics 1977, UNCTAD.

Table 3

MAJOR EXPORTS OF PAKISTAN TO SELECTED AREAS
1970
(Value in U.S. thousand dollars)

Destination Commodities	SITC	World	Western Europe Total	EEC	EFTA Total	U.K.	U.S.	Canada	Japan
Fish Fresh, Simply Prsvd.	031	19049	1609	321	1288	1253	5422	–	5416
	%	100.0	8.5	1.7	6.8	6.6	28.5	–	28.4
Rice	042	26712	1168	83	1085	1085	6	2	1
	%	100.0	4.4	0.3	4.1	4.1	0.02	0.0	0.0
Cotton	263	53351	5233	2999	1234	352	472	39	10282
	%	100.0	7.9	5.6	2.3	0.6	0.9	0.07	19.3
Leather	611	31055	22000	16426	5574	2592	286	–	3988
	%	100.0	70.8	52.9	17.9	8.3	1.0	–	12.8
Text Yarn and Thread	651	64783	4357	3354	1003	888	98	2.2	6356
	%	100.0	6.7	5.2	1.5	1.4	0.2	0.03	9.8
Cotton Fabrics Woven	652	58705	20435	8581	11854	11634	6957	1447	44
	%	100.0	34.8	14.6	20.2	19.8	11.8	2.5	0.07
Text. etc. Prod. NES	656	60450	9191	7614	1577	780	689	33	2
	%	100.0	15.2	12.6	2.6	1.3	1.1	0.05	0.0
Floor Govt. Tapes etc.	657	13493	9360	4341	5019	3513	1167	48	18
	%	100.0	69.4	32.3	37.2	26.0	8.6	0.4	0.1
Clothing not of Fur	841	5292	1556	661	895	525	1614	389	82
	%	100.0	29.4	12.5	16.9	9.9	20.5	7.4	1.5
Footwear	851	5561	1823	823	1000	606	90	6	9
	%	100.0	32.8	14.8	18.0	10.9	1.6	0.1	0.2
Toys, Sport Goods etc.	894	6664	3588	1828	1760	1250	1248	148	20
	%	100.0	53.8	27.4	26.4	18.8	18.7	2.2	0.3
All Prod.	0-9	723400	187383	95435	91948	75313	85105	9537	42348
	%	100.0	25.9	13.2	12.7	10.4	11.7	1.3	5.8

Source: OECD Trade Statistics Series C. 1970

the commodities for which the area is more important fall in the manufac-
tures and semi-manufactures class. This distinguishes Pakistan from most
other developing countries. Fourth, within the EFTA, the U.K. alone
imports more than 70 per cent of the EFTA's total imports from Pakistan.
If we exclude leather, the percentage is higher than 80%. The other
countries of the EFTA are not of major importance to Pakistan. This is
true, more or less, for other developing countries as well.

4. THE INCIDENCE OF THE COMMON EXTERNAL TARIFF

The Treaty of Rome, which brought the EEC into being,
required the member states to replace their national tariffs by a Common
External Tariff (CET). The level of the CET had to be negotiated.
Since all the six countries were signatories of the General Agreement
on Tariffs and Trade (GATT), they were committed to the provision that
the level of CET should not be higher than the national tariffs that
it replaced. Within this limit, the low tariff members specially
Benelux countries desired CET to be very low so as to protect their
import-using consumers and producers. On the other hand, the high
tariff members - France and Italy - wanted it to be higher, to protect
their producers of import-competing goods. The architects of the EEC
wrestled for a long time with this issue. In the end they decided that,
after making some important exceptions to take account of highly valued
national interests, the rule for determining the CET should be the simple
unweighted arithmetic average of the rates of the members as on Jan. 1, 1957,
with Benelux counting as one area.

The Community claimed that it had met the GATT requirement
that CET, "should not have a more protective effect than the national

tariffs that it replaced". But the other countries considered this contention to be unacceptable. They argued that the GATT rules demand not he unweighted arithmetic mean but a weighted one. They maintained that the simple arithmatic mean would tend to have an upward bias because the high rates of France and Italy would be given as such weight as the low ones of Benelux and Germany, even though the volume of trade of the latter was greater than that of the former.

Some studies were made in this connection Frank, I., found that the weighted index probably yielded a lower Common External Tariff $\underline{/3\_7}$. Balassa on the other hand concluded that there was no significant difference $\underline{/1\_7}$, while R. Hinshaw found the weighted level to be substantially lower if all goods were included, but only slightly lower for manufactured goods $\underline{/5\_7}$. It should also be recognised that in calculating the arithmetic averages, the Six used the duties which they had a "legal" right to use as of January 1, 1957. These rates were, however, in many cases appreciably above the rates "actually" being applied at that date. This was so, largely because the calculation did not take into account the 25 per cent "business cycle" reduction by Germany in 1957 or the ten per cent cut in the Italian tariff.

In this regard a GATT Working Party concluded that the general incidence of the Common External Tariff on imports into the Common Market was lower (by about ten per cent, Common Market spokesmen said) than the general incidence of legal or bound rates in member states on the base date. But it seemed to be higher (and for some countries it worked out to as much as 30-40% higher) than the general incidence of the rates actually encountered by exporters to the common market countries on January 1, 1957 $\underline{/4\_7}$

It is also questionable whether the protectiveness of
the CET can be determined merely by looking at the increases and
decreases in national tariffs required to reach the calculated level.
For a producer within the Community who was previously protected by a
high tariff, the most serious challenge will come from low cost
producers within the Community. The essence of economic integration
depends on this kind of competition taking place. Thus, the prices of
the large low cost producers in the Coomunity will set the competitive
level for the entire market. The Common External Tariff will be protective
only to the extent that it protects the firms that can survive the
internal competitive struggle.

Krause /¯6_/ analysed the protectiveness of the external
tariff by estimating the amount of protection it provides to the dominant
low cost suppliers within the EEC. The dominant suppliers were identified
by looking at the trade flows among the member countries before the
establishment of the Community. It was assumed that the dominant
suppliers of particular product class were to be found in the country
which had the largest share of intra-community trade in that product
class. On can compare the level of the external tariff for each commdity
class with the former national tariff of the country with the largest
share of intra-community trade. If the new tariff rate is higher than
the old national rate, then the amount of protection it affords is
greater than before and vice versa. After a comparison of the common
external tariff for 61 three-digit SITC commodity classes with the
former national tariffs protecting the dominant suppliers. The concluded
that 75 per cent of all manufactured products would have their
protection raised, and by large amounts.

5. THE RATE OF DISCRIMINATION

Whether or not the CET is more protective, it certainly involves discrimination against outsiders and places the members in a relatively advantageous position. The provision that members would face no restrictions in trade with each other while maintaining a common external tariff, introduces an element of discrimination against third countries. Tinbergen has investigated this aspect $/$ 11 $/$. He defined the "rate of discrimination " as the difference between the import duties levied on imports from outsider countries and the duties imposed as an average on all imports. The latter consist partly of imports into the EEC from partner countries and the Associated Overseas Territories (AOT) and to that extent are exempt from tariffs. In general, the average duty varies between zero (if all imports of the given commodity originate within the EEC and AOT) and the CET rate (if all imports of a commodity originate outside the Community and the AOT countries). He computed "rate of discrimination" in the EEC against 21 countries including Pakistan. The figure for Pakistan came out to be 0.00 i.e. Pakistan did not face any discrimination.

Though Tinbergen's calculations may not longer hold, since his formula was applied to the 1955 pattern of trade, his technique is a useful one. For an assessment of the changed situation since 1955 for various countries, it is necessary to re-evaluate the "rate of discrimination". In the following paragraphs the change in the "rate of discrimination" against Pakistan's exports is analysed as a case study.

The simple inference which can be drawn from the 0.00 rate of discrimination reported above, is that in 1955 (1) the magnitude of

Pakistan's trade with the EEC countries was very small (ii) the commodities exported by Pakistan were not heavily protected.

In 1955, Pakistan's exports to the EEC largely consisted of raw materials, especially cotton and jute, on which there was a zero tariff in the EEC countries even prior to the union, and there was also virtually no competition to Pakistan's exports within the countries that now form the EEC. The situation has radically changed since 1955. Not only has the magnitude of Pakistan's exports to the EEC countries increased significantly, but also the share of manufactured goods in the total exports of Pakistan has gone up. In the present conditions, the "rate of discrimination" in the Community against Pakistan's major manufactured exports -- cotton fabrics, woolen carpets, leather and sports goods etc. is high: as the tariff wall in the Community for these goods is fairly high and effective competition exists in the Community against these Commodities. It is therefore, appropriate to re-evaluate the rate of discrimination for Pakistan's exports to the Community in view of these major changes. This has been done on 1970 data.

For any commodity i, let the Common External Tariff be t (expressed as a percentage of the value of imports). Let p be the proportion of imports of commodity i into the community from other member countries and its Overseas Associates, so that the share of imports from third countries is $1-p$.

The third countries pay t per cent on their exports while Community and Associate suppliers pay 0 per cent, so that the average rate of duty on imports of commodity i into the EEC is $0.p + (ti_{-p})=t(1-p)$. The rate of discrimination is the difference between the duty paid by a third country (t) and the "average" duty paid on imports of that commodity

into the community i.e., the rate of discrimination is $t-t(1_{-p}) = t_p$.

Thus, if there are no suppliers of the commodity within the Community and its Associates i.e., p = 0, the rate of discrimination is also zero. Similarly if p = 1 then the rate of discrimination is equal to t. The larger the share of Community suppliers, the more the rate of discrimination approaches the Common External Tariff.

The average rate of discrimination against any county i can be calculated either as a simple arithmetic average of the rates of discriminations against the commodities that country i exports to the EEC i.e.,

$$ROD = \frac{1}{N} \sum_{i=1}^{N} rod_i \qquad \ldots\ldots \quad (1)$$

Where ROD is the average rate of discrimination against any country and rod_i is the rate of discrimination against commodity i.

Alternatively, ROD_w can be calculated as the weighted average of the rates of discrimination for individual commodities, the weights being the values of exports of each commodity to the Community from country i. i.e.,

$$ROD_w = \sum_{i=1}^{N} \frac{rod_i \cdot v_c^i}{V_c} \qquad \ldots\ldots \quad (2)$$

Where V_c stands for all exports by country i to the community.

The results of these calculations are reported in Table 4. It is seen that the unweighted average rate of discrimination comes out to be 3.2 per cent and the weighted average to be 2.2 per cent, which is quite high compared to zero per cent that Tinbergen came up with.

6.   THE IMPORT PERFORMANCE OF THE EEC AND EFTA

The previous anlaysis has shown that the formation of the
EEC and the EFTA has adversely affected the cometitiveness of the
non-member countries by placing the member countries in a relatively
advantageous position.   In case of the EEC there has been the additional
impact of the Common External Tariff which seems to have increased the
level of protection compared to the national tariffs.   These developments
are expected to have caused trade diversion against the non-member
countries.   On the other hand it is usually maintained that due to the
dynamic effects of customs unions, the rates of growth of the member
countries may have been favourably affected which will result in an
increase in imports from all sources, given the import elasticity.
To see the net effect, it is imperative to analyse the ex-post import
performance of these trading blocs. To this we now turn.

The total foreign trade of Western Europe increased in
current values at 12.0 per cent a year between 1955 and 1975, which
compares favourably with a 10.1 per cent increase for the United States
and 10.3 per cent for Canada and is also higher than the increase in
total World trade (11.9 per cent). However, as the figures presented
in Table 5 indicate, the trade among West European countries rose much
faster than the trade with rest of the world. The intra-trade increased
at a rate of 13.2 per cent annually in current values while imports
from rest of the world increased at only 10.3 per cent. The implication
is that Western Europe's trade dependence on the rest of the world
has been decreasing since the mid- 1950s and Western Europe has been
turning inward. In 1975, for example, 62.1 per cent of its imports came

TABLE 4

Calculations of "Rate of Discrimination" in the EEC on Exports from Pakistan in 1970

	World	EEC	Associated Territories	Row	Average Duty on imports $t(1-p)$	Duty on imports from Pak. t	Rate of Discrimination rod_i	Volume of Imports from Pak. v^i_c	$rod_i \, V^i_c$
Raw Cotton	560097	17073	161835	381189	0	0	0	2907	0
Cotton Fabrics	340561	201581	5080	133900	6	15	9	2287	20583
Hides & Skins	380597	87132	10107	283358	0	0	0	833	0
Leather	262318	138085	2205	122028	1.4	3	1.6	16383	26213
Footwear	446983	372225	2985	71718	1.3	8	6.7	720	4824
Medical Instruments	80271	34238	-	46033	4.6	8	3.4	494	1680
Fish & Preparations	431519	143784	29586	258248	7.2	12	4.8	700	3360
Rice	65229	17474	10210	37545	6.9	12	5.1	1051	51
Woolen Carpets (knotted)	127817	2826	2112	122879	23	24	1.0	4308	4308
Wool & Animal hair	672213	169122	118550	384541	0	0	0	467	0
Sports Goods	63263	24632	-	38531	6.1	10	3.9	1824	7114

$$ROD = \frac{1}{N} \sum_{i}^{N} rod_i = \frac{35}{11} = 3.2 \qquad ROD = \frac{\sum_{i-1}^{N} rod \cdot v^i_c}{V_c} = \frac{68137}{30933} = 2.2$$

from other countries in the region as compared to 49.8 per cent in
1955.

If we look at the figures more carefully, (see Appendix
Table I) it becomes evident that far the biggest increase in West
European trade have been the expansions of trade within the two trading
blocs -- the EEC and EFTA -- and especially the expansion of trade within
the EEC.   In the mid- 1950s, the intra-trade of the six member countries
of the EEC was only about one-sixth of Western Europe's total trade;
by 1975 it had increased to one-third.   The intra-trade of the EFTA was
much less and also increased at a slower rate.   The expansion of trade
between the two blocs was smaller as compared to the expansion of
trade within each bloc.   The EEC imports from members increased at 15.3
per cent per year as compared to 11.6 per cent for imports from the
EFTA.   Similarly the imports of the EFTA from its members rose by 13.0
per cent per year while those from the EEC increased at 12.2 per cercent.
The result has been that the members of each of the two blocs have tended
to trade more and more within their circuit.   This has been due to the
preferential treatment given to the members viz-a-viz non-members.   In
1955, before the preferential tariff margins began to bite, the six EEC
countries did about one-third of their total trade with one another.
By 1975 the proportion of intra-trade had come to around one-half.
The intra-trade of the EFTA over the same period of time increased from
less than one-sixth to about one-quarter of the region's total trade.
If we compare the two blocs, it turns out that the import performance of
the EEC has been better than   that of the EFTA for intra-trade as
well as for the extra - trade.

Table 5

Network of World Imports 1955, 1975: Shares of Importing
Area by Origin and Rate of Growth

1955 - 1975

		World		W.Europe (Total)		E E C		E F T A (Total)		U. K.		U. S.		Canada		Japan		Developing Countries	
		% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth	% Share	Rate of Growth
World	1955	100.0	11.8	100.0	12.0	100.0	13.1	100.0	10.4	100.0	8.4 12.7	100.0	11.1	100.0	10.3	100.0	17.0	100.0	17.0
	1975	100.0		100.0		100.0		100.0		100.0		100.0		100.0		100.0		100.0	
Western Europe (Total)	1955	35.2	12.7	49.8	13.2	48.2	14.5	41.9	12.8	23.2	12.7	19.1	11.8	13.4	9.9	6.9	17.1	37.7	17.1
	1975	41.6		62.1		62.2		64.1		50.7		21.5		12.4		7.0		32.5	
E E C	1955	20.2	13.5	29.2	14.1	32.3	15.3	26.0	12.2	13.1	12.9	10.2	12.3	3.3	13.6	4.2	16.5	21.7	16.5
	1975	27.5		42.9		47.7		36.3		29.4		12.5		5.9		3.8		21.3	
E F T A (Total)	1955	15.0	10.6	16.7	13.0	16.0	11.6	15.9	13.0	10.0	11.0	8.9	10.1	10.0	7.6	2.7	17.4	16.0	17.4
	1975	12.0		16.7		12.4		24.7		16.0		7.4		6.0		2.9		9.5	
U. K.	1955	8.9	8.7	6.7	10.9	6.0	11.9	5.2	10.7	--	--	5.1	9.9	9.0	5.5	1.8	15.4	12.2	15.4
	1975	5.0		5.6		4.9		5.6		--		4.1		3.7		1.3		5.6	
U. S.	1955	16.5	10.1	13.0	9.1	13.5	10.0	10.4	8.2	10.5	7.7	--	--	69.0	10.3	31.3	14.0	24.8	14.0
	1975	12.2		7.7		7.7		7.0		9.1		--		67.9		18.6		19.0	
Canada	1955	4.7	10.3	3.0	7.1	1.4	11.1	5.4	4.6	8.2	4.1	23.3	11.0	--	--	4.2	16.9	1.4	16.0
	1975	3.7		1.2		1.0		1.9		3.6		22.6		--		4.1		1.4	
Japan	1955	2.1	18.1	0.5	20.5	0.4	21.4	0.6	19.6	0.6	17.2	4.0	17.4	1.0	17.5	--	--	5.0	--
	1975	6.4		2.1		1.7		2.8		3.1		12.0		3.6		--		13.0	
Developing Countries	1955	25.4	11.5	24.4	10.8	27.0	11.8	24.1	8.6	33.3	6.8	48.6	10.1	8.3	13.0	44.7	18.4	24.9	18.
	1975	19.1		24.1		21.0		15.6		24.8		40.7		13.5		56.0		24.2	

Source: Appendix Table 1.

These Increases obviously have been at the cost of non-member countries. It is Interesting to note that the Industrial countries did not suffer as much as the less developed countries. However, because the amount of exports of the Industrial countries is very large, the loss has been substantial In absolute terms. At the same time the share of developing countries in the EEC's total Imports has declined from 27 per cent In 1955 to only 21.6 per cent In 1975. The corresponding shares In EFTA's Imports are 24.1 for 1955 and 15.6 for 1975.

(II)   Trade Creation and Trade Diversion

Formation of a customs union may affect resource allocation In two ways: (I) the new supply from a partner country may displace high-cost domestic production, hitherto protected by a tariff. (II) The new Intra-union supply may displace a member's Imports from a low-cost source outside the union. As an example of the first, consider the following cost position.

USA	ITALY	FRANCE	
$ 100	$ 120	$ 150	(Original cost position)
$ 160	$ 192	$ 150	(60% duty is Imposed by France)
$ 160	$ 120	$ 150	(After Italy and France from a customs union)

Before the formation of the customs union, In France the domestic producers supply the market at $ 150. But after the union Is formed, Italian production enters the French market at $ 120 and displaces the higher-cost domestic production. This Is called "trade creation". Whereas International trade did not exist before, It would have been created. It results In a better utilization of resources through

specialization. For an example of the second, suppose the duty had been only 30%. The situation would appear as follows:

	USA	Italy	France	
	$ 100	$ 120	150	(Original cost position)
	$ 130	$ 156	$ 150	(30% duty is imposed by France)
	$ 130	$ 120	$ 150	(After Italy and France from customs union).

Before the customs union, France would import from the US at a price of $ 100 and with a 30% duty. After the union is formed Italy will displace previous imports from the US --- a low cost source. This is called "trade diversion". It reduces the efficiency of world resource utilization.

To sum, the formation of a customs union gives rise to two conflicting forces. Since the members of a nunion eliminate trade barriers for each other but maintain (or escalate) them for the outsiders, the formation of a union is expected to result in an increase in the trade among the members but at the same time it will decrease the trade with non-members as compared to what the trade level would have been if the union had not been established. To estimate these effects, there are a number of techniques. The most popular one is to estimate the imports of the integrating countries in the assumed absence of economic integra-tion. The effect of integration is then the difference between the estimated imports of the member countries and their actual imports in some postintegration year.

To construct the hypothetical estimates usually some pre-integration growth rates are projected under the assumption that these

trends would have continued had it not been for the integration $\underline{/}\text{`}13\underline{\text{`}}7$.

The techniques range from simple extrapolation of pre-integration growth

rates of imports from internal and external sources, to extrapolation

of a world trade matrix. All of them have their own biases and it is

by no means clear that more sophisticated techniques are necessarily

better. There is a consensus among the writers in the field that the

magnitude of no single estimate can be taken too seriously. It is

only the collective evidence derived from studies using a variety of

approaches that can provide an idea of the orders of magnitude involved.

In our case, we estimated simple import functions for the

period 1951-59 both for the intra-trade and for imports of Western Europe

from developing countries. These equations were then projected to get

the estimated level of imports in 1970. The difference between actual

and predicted volumes gives the integration effects.

$$\ln M^{WE} = \alpha_0 + \alpha_1 \ln Y^{WE} \qquad \ldots \ldots \qquad (3)$$

$$\ln M^{LDC} = \beta_0 + \beta_1 \ln Y^{WE} \qquad \ldots \ldots \ldots \qquad (4)$$

where M^{WE} and M^{LDC} are imports of Western Europe from Western Europe

and developing countries respectively and Y^{WE} is the gross national

product of West European countries.

Before giving the results, it should be pointed out that there

are variables other than the GNP which might affect the imports of

Western Europe*. The most obvious of those is the relative price

variable. However, the data on relative prices are notoriously unreliable

and in case of underdeveloped countries even those are not always

available. Moreover, the results of the studies which tried that variable

* I have benefited from my discussion with A.R.Kemal and Moazzam
Mahmood on this point, for which I am grateful to these gentlemen.

Indicate that the relative price effect is relatively unimportant in explaining trade flows. In his study of trade creation and trade diversion by the EEC and EFTA, Kreinin found that "the relative price coefficient is almost invariably insignificant and/or carries the wrong sign" /¯7_7. In his classic study on this subject Balassa also reported that inclusion of relative prices in the analysis did not improve the results /¯2_7. Again, Truman maintained "The limited available data on price competetiveness for all manufactured products were examined and they lend little systematic support to the view that the results are dominated by such factors" /¯12_7. Finally, after surveying a large number of papers, Sellekaerts concluded, "excluding relative prices is not a major loss, because the estimates of the relative price elasticities are often statistically insignificant and carry the wong sign". /¯ 10_7.

We have, therefore, ignored relative prices in our study. The results of our exercise are reported in Table 6. The trade creation effect comes out to be 39921 million dollars and trade diversion against developing countries alone is estimated to be 8928 million dollars. However, as pointed out earlier, these estimates should be considered only approximate.

It would have been more revealing if the import functions could be estimated at a disaggregated level. Due to data limitations that could not be done. However, we can have some idea about the integration effects for different commodity groups by looking at the "market shares" for those commodities. Table 7 shows these share for five product classes in 1955 and 1975.

Table 6

Estimates of Trade Creation and
Trade Diversion (1970)

Estimated Equations

Equation 1 $\ln M^{WE}$ = 5.9 + 0.709 $\ln Y^{WE}$
(12.36)

R^2 = 0.956   F.Ratio = 152.90

Equation 2 $\ln M^{LDC}$ = 8.2 + 0.317 $\ln Y^{WE}$

R^2 = 0.828   F Ratio = 32.44

	From West Europe	From Developing Countries
Projected Level of Imports	39039	29408
Actual Level of Imports	78960	20480
Difference	+39921 (Trade creatio n)	-8928 (Trade creation)

Table 7

Imports of Western Europe by Selected
Commodity Classes (1975)

(Shares by Origin)

		Food Beverages & Tobacco	Agri. Raw Materials	Ores and Metals	Fuels	Manufactured Goods
World	1955	100.0	100.0	100.0	100.0	100.0
	1975	100.0	100.0	100.0	100.0	100.0
Western Europe	1955	32.41	32.14	53.0	38.59	78.5
	1975	55.11	52.33	62.64	20.26	80.72
EEC	1955	16.45	10.03	36.13	30.58	49.35
	1975	38.15	24.46	44.15	15.24	55.09
EFTA	1955	9.39	14.97	14.11	8.01	26.42
	1975	10.64	26.01	16.27	4.44	22.72
U.K	1955	1.01	1.9	4.22	7.52	11.94
	1975	3.06	3.37	4.63	2.2	7.76
U.S.	1955	12.59	7.53	11.15	8.62	7.89
	1975	13.19	7.34	4.63	1.8	6.18
Canada	1955	4.35	2.53	7.6	0.10	1.95
	1975	1.72	4.59	4.59	0.16	0.6
Japan	1955	0.4	0.5	0.62	—	1.02
	1975	0.37	0.8	2.95		2.15
Developing countries	1955	37.88	35.88	22.18	0.05	5.63
	1975	21.33	17.56	14.91	45.63	5.8

It can be seen that the share of West European market
held by the countries within the area has increased in every major
product group except one: fuels. The effect of relative diversion
from outside sources is particularly significant in agricultural
products. The share of West European countries in the region's market

for "food, beverages and tobacco" increased from 32.41 per cent in 1955 to 55.11 per cent in 1975. Similarly in "agricultural raw materials" The intra-trade increased to 52.33 per cent from 32.4 per cent in the same period. In both of these groups, the relative expansion of intra-trade was almost wholly at the expense of imports from developing countries. Their share of West Europe's imports of these two groups, the only groups (apart from oil) in which the third world holds a substantial footing, fell from 37.17 per cent in 1955 to 20.45 per cent in 1975.

7. SUMMARY AND CONSLUSION

The formation of the EEC and the EFTA has significantly altered the pattern of world trade. The evidence provided in this paper establishes that the Western Europe has been turning inward on itself. The intra-trade of the region has increased at much faster rates than the trade with countries outside the region. Due to the preferential treatment given to the members the discrimination against the outsiders has been intensified with the result that they have lost grounds to the members in most of the product classes. The under-developed countries have been the worst affected.

Since the area is of immense export interest to the less developed countries the partial loss of this market had important implications for trade and development policies of many countries. Some saw the developments in the West to be based on an exploitation of the primary producing countries through trade, and to others the protectionist policies of these countries were one of the biggest obstacles in the development of poorer nations $\underline{/}$ 8, 9 $\underline{7}$. We believe,

Appendix Table 1

Network of World Exports 1955, 1975

Distination / Origin	Year	World	Western Europe		E F T A		U.S.	Canada	Japan	Developing countries
			Total	E E C	Total	U.K.				
World	1955	93,540	39,170	19,240	16,180	9,510	11,390	4,390	2,170	23,240
	1975	872,530	375,250	224,790	116,930	48,020	94,070	31,470	50,510	199,980
Western Europe(Total)	1955	32,950	19,500	9,280	6,780	2,210	2,180	590	150	8,770
	1975	362,850	233,170	140,650	75,000	24,330	20,220	3,900	3,550	65,100
EEC	1955	18,920	11,450	6,210	4,210	1,250	1,160	145	91	5,050
	1975	240,170	160,950	107,320	42,460	14,110	11,800	1,860	1,930	42,560
E F T A (Total)	1955	14,030	6,550	3,070	2,570	960	1,020	440	59	3,720
	1975	105,040	52,690	27,840	23,930	7,690	6,950	1,890	1,450	19,090
U.K.	1955	8,300	2,640	1,160	850	–	580	395	38	2,840
	1975	43,760	20,870	11,070	6,500	–	3,820	1,160	670	11,150
U.S.A.	1955	15,430	5,080	2,590	1,680	1,000	–	3,030	680	5,760
	1975	106,160	28,800	17,380	8,190	4,390	–	21,360	9,420	37,970
Canada	1955	4,390	1,170	270	880	780	2,650	–	92	325
	1975	32,300	4,630	2,230	2,180	1,750	12,230	–	2,080	2,900
Japan	1955	2,010	195	81	90	61	455	46	–	1,160
	1975	55,750	8,080	3,930	3,250	1,470	11,260	1,150	–	27,490
Developing countries	1955	23,730	9,540	5,190	3,900	3,170	5,540	365	970	5,790
	1975	210,010	74,820	48,630	18,310	11,920	38,330	4,240	28,270	48,370

that the developments in Western Europe, were one of the factors

contributing to the 'export-pessimism'' which forced many underdeveloped

countries to adopt the expensive path of import - substituting growth.

There has been a growing demand on the part of less developed countries,

for better access to the markets of developed countries.   Various rounds

of tariff reduction under the auspices of the GATT, the United Nations

Conference on Trade and Development and the Generalised System of

Preferences were triggered mainly by the institutional changes in

Western Europe and the resulting pressures from LDCs. Unfortunately,

the practical significance of these institutions has been only

limited. A lot more needs to be done to ensure better export prospects

for the developing countries. The inward-looking policies of West

European countries are in clear contradiction to their promise of

helping the less developed countries to grow. The developing countries

cannot afford any less of West European market. If the Western countries

are true to their premise, a non-discriminatory (if not preferential)

troatmetn for all imports from developing countries is a bare minimum.

Appendix Table 2

Imports of Western Europe and World by Selected Commodity Class
(1955, 1975)

Categories / Imports From	SITC / Destination	Food, Beverages and Tobacco 0 + 1 + 22 + 4		Agricultural Raw Materials 2 - 22 - 27 - 28		Ores and Metals 27 + 28 + 67 + 68		Fuels 3		Manufactured Good 58 to 8 less(76+68)	
		World	West Europe	World	West Europe	World	West Europe	World	West Europe	World	West Europe
World	1955	20410	10090	12030	6160	11410	5500	10270	4120	20930	6870
	1975	115570	53970	34400	16340	85010	37550	168560	70200	209970	104660
Western Europe	1955	5060	3270	2680	1980	4593	2915	2030	1590	3534	5410
	1975	39550	29740	10360	8550	37070	23520	17720	14220	129450	84480
EEC	1955	2350	1660	844	618	2963	1987	1590	1260	6350	3390
	1975	26020	20590	4630	3980	26330	16580	13610	10700	80370	57660
EFTA(Total)	1955	1620	947	1220	922	1432	776	420	330	4810	1815
	1975	8850	5740	5240	4250	8900	6110	3540	3120	38280	23780
U.K.	1955	550	102	249	117	733	232	390	310	3000	820
	1975	3230	1650	810	550	3070	1740	1800	1540	15520	8120
U.S.	1955	2540	1270	962	464	1307	613	1130	355	3410	542
	1975	20870	7120	4400	1200	6020	1740	4470	1240	21550	6470
Canada	1955	948	439	837	156	1127	418	59	4	1126	134
	1975	4400	930	3090	750	5160	1724	5330	110	4530	625
Japan	1955	154	40	97	31	328	34	7	-	1174	70
	1975	810	200	760	130	10775	1109	220	36	15060	2250
Developing countries	1955	8670	3830	4860	2210	2391	1220	5990	1880	1672	387
	1975	33170	11510	9000	2870	12140	5600	124580	47660	23220	6070

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