These barriers lead to lower productivity, less innovation, higher prices. They undermine the competitiveness of European companies which rely on these products and services as key inputs to their business process.

The CAG **recommends** that immediate action be taken at the level of the European Union to reduce institutional barriers to trade and investment within Europe by:

- **completing and extending telecommunications liberalisation on schedule;**
- **ensuring that the new timetable for liberalisation of electricity markets decided last June will be respected and that market forces will play their full role;**
- **extending the Single Market to areas not presently covered, notably indirect taxation.**

Our **key benchmark** is "the share of total activity in Europe's main industrial and commercial sectors (including, *inter alia*, telecommunications, energy production and supply, financial services) which is fully open to international competition".

II. 2. Barriers to trade with major international markets

Despite substantial progress through GATT, barriers to international trade between Europe and the major international markets still exist. The main barriers to direct market access for European firms are:

- **restrictive import policies**, particularly tariffs, quasi-tariffs such as customs usage fees, quotas, import clearance procedures and the overt banning of specific imports;
- **the misuse of technical barriers**, including testing requirements, labelling rules and certification procedures;
- **discriminatory government activity**, particularly in the areas of public procurement, the applications of regulations and the provision of commercially sensitive information, selectively, to local competitors;
- **indirect discriminatory activity**, including weak intellectual property protection, differential fiscal policies and anti-competitive business practices by companies and business organisations.

- In **South Korea**, there are high tariffs and quota restrictions on agricultural products and higher value food products which, combined with major import clearance problems, severely discriminate against imports.
- The **US Clean Air Act** issued a 'Gasoline Rule' introducing standards for the sale of gasoline which have the effect of discriminating against imported products.
- In the **Japanese** automotive aftermarket, complex regulations governing vehicle inspection, modification and repair encourage consumers to have vehicles repaired at franchised dealerships or certified garages stocking almost exclusively manufacturers' original equipment parts. This effectively limits the access of foreign suppliers to the large spare parts market in Japan.
- In **China**, inadequate intellectual property protection and weak government enforcement (especially amongst producers and distributors) has led to a massive counterfeiting problem. This has a major affect on foreign suppliers of compact discs, videos and software.

As a result, the ability of European companies to increase their penetration of key international markets, particularly the high growth markets of Asia, is hampered.

The CAG **recommends** that the European Union and Member States take action to:

- **enhance multilateral opening up of trade and investment and avoid unilateral action and preferential treatment;**
- **improve the *effectiveness of the WTO* through: *reinforcing* of the disputes procedure; extension of existing agreements to other major trading nations currently excluded (such as China); negotiating agreements for other areas not presently covered, such as important service sectors;**
- **improve the ability of the European Union to negotiate at the world level. The Union must incorporate in the field of application of Article 113 of the Treaty notions of services, intellectual property, and foreign direct investment, for which one single body in the Commission should then be made responsible.**

Our **key benchmark** is: "Europe's level of access to the six most rapidly expanding markets in Asia relative to that of our most relevant competitor" (China, India, Indonesia, Japan, South Korea and Thailand).

II. 3. Barriers to international investment

For many companies, Foreign Direct Investment is no longer a choice. To remain competitive, multinational companies are creating transnational networks in which different parts of the value-chain are located wherever they contribute most to the company's overall performance. FDI thus plays a critical role in the strategies of many companies. Moreover, traditional distinctions between FDI and exports have been eroded. They have become complementary approaches within an integrated transnational system.

World-wide foreign direct investment has grown substantially in recent years. Indeed, since the beginning of the 1980s, the annual growth rate of FDI stock has consistently outstripped that of world output, gross domestic investment and world exports.

Europe is a major recipient of foreign investment (circa ECU 250 billion) from outside the EU. Disparities between the EU-15 are, however, striking. Inbound FDI expresses a vote of confidence on the part of the foreign investor in the openness of the economy concerned. Europe is also a major investor in overseas markets, with a current FDI stock of circa ECU 300 billion outside the EU. Key trends are as follows:

Inbound foreign direct investment

Inbound FDI improves competitiveness, stimulates growth and creates jobs. It does this by improving the operating efficiency of existing companies and their suppliers, by stimulating innovation in products, services and internal processes, and by encouraging companies to adapt to change.

Governments have a strong role to play in creating a business environment that is attractive to foreign investors. Long term, however, the offer of competing incentive packages will not overcome reluctance to invest based on realistic assessment of comparative advantage.

The CAG **recommends** that action be taken by the European Union and Member States to:

- **discourage competition on incentives.**

Outbound foreign direct investment

Foreign investment by European companies strengthens the competitiveness of Europe. It does this by improving the capability of European companies to penetrate new markets, to innovate and to adapt their businesses in response to new and changing conditions.

However, substantial barriers to investment by European companies in international markets remain. The main barriers to achieving market presence through investment are:

- **direct restrictions**, including screening procedures, limitations on establishing new businesses, land ownership restrictions, restrictions on levels of investment and foreign ownership, local partner requirements and licensing;
- **restrictions on business activity**, particularly restrictions on transfer of funds, foreign staff, financing and operations (such as local content rules, export performance and technology transfer);
- **discriminatory government activity**, particularly in public procurement, the application of regulations, fiscal policies and participation in government-sponsored R&D programmes;
- **indirect discriminatory activity**, such as weak intellectual property protection, provision of subsidies selectively to local companies and anti-competitive practices by companies and business organisations.

- A wide range of complex rules and regulations effectively prohibit foreign participation in large parts of **South Korea's** valuable insurance, banking and securities markets.

- In the newly liberalising telecommunications market in **Taiwan**, foreign firms face participation restrictions and limits on the returns that can be earned from their investments.

- In **Indonesia**, recent preferential treatment given to the 'national car project' (exclusive exemption from luxury taxes and import duties on components) discriminates against foreign car manufacturers, setting worrying precedents for possible similar behaviour in other sectors.

  Concerns remain about the level and nature of **Japanese** intellectual property protection, including the narrow patent interpretation practices in Japanese courts.

As a consequence, the ability of European companies to increase their level of investment in key markets outside Europe is impaired.

The CAG **recommends** that the European Union take action:

- **to ensure that the scope of the WTO is extended to cover equal treatment for national and international investments;**
- **to ensure that the Multilateral Agreement on Investment, which is being developed for OECD countries, is completed and implemented as quickly as possible.**

Our **key benchmark** is an 'FDI score' (that is, the extent to which conditions for foreign investment by European companies in the six key Asian markets meet OECD standards).

Infrastructure Investment in Emerging Economies

This is a special example of outward FDI. It is of particular importance because of its size.

Markets for water treatment, power generation, telecommunications and transportation in emerging economies offer European companies major opportunities to improve competitiveness and create jobs. Emerging markets are huge in scale and still have enormous potential for future growth.

- Orders for power generation equipment grew at 2% per annum in Europe in the period 1985 to 1995, compared to 15% per annum in Asia. In India alone, it is estimated that nearly $200 billion will need to be invested in new generating capacity over the next decade.
- In terms of future potential, access to infrastructure in emerging countries is significantly less than that in the developed world. In Indonesia, for example, there are only 2 main telephone lines for every 100 people, compared with an average of more than 60 in OECD countries.

Growth in demand for investment in infrastructure is being driven by a range of factors: economic growth, urbanisation, population growth, renewal of out-dated facilities, deregulation and privatisation. At the same time, market opportunities are becoming more varied as emerging countries seek new ways around the problem of funding major investments in infrastructure.

Traditionally, European companies have supplied capital equipment and construction services to public utilities, with funding from multilateral and bilateral sources. Whilst this form of market opportunity will continue to be important, it will be complemented by new opportunities. These involve companies supplying the final products and services, and using facilities that they have designed, built and financed.

New demands are placed on European suppliers. To complement their traditional expertise, they must develop new competencies in project finance and service provision. Furthermore, now that Europe's own utilities are ceasing to be state-owned domestically-oriented monopolies, they have the chance to become global players, selling their know-how in international markets and making direct investments.

Europe's ability fully to exploit these opportunities depends on:

- **Availability of appropriate sources of finance and financial guarantees.** Most projects are large and lengthy. Companies require access to capital to finance the project and working capital, access to risk insurance and to guarantees. European companies must be placed on a similar footing as their competitors.
- **Continued development of market opportunities.** This means maintaining progress in market liberalisation, privatisation and deregulation in emerging economies.
- **Access to markets.** European companies must have the opportunity to tender for business on terms similar to those enjoyed by local competitors.

To improve the position and performance of European companies in infrastructure markets in emerging economies, **the CAG recommends** that:

- **the major European institutions, such as the EIB and national bilateral financing agencies, should shift their lending away from public sector projects towards public/private sector partnerships, particularly in Central and Eastern Europe. At the same time, the EIB should increase its funding of projects outside the EU in emerging markets, such as Asia;**
- **the European Union should establish a benchmarking programme to enable Member States to compare their financial support for companies participating in infrastructure projects with the best in the OECD, and then assist with the transfer of best practice;**
- **the trade policy of the European Union should include among its objectives the fostering of market liberalisation in the utilities sectors of emerging economies. Member States should empower the European Commission to take appropriate steps to apply in all utilities sectors the recommendations formulated in the Commission's Communication 'Europe-Asia Co-operation Strategy for Energy'.**

Obstacles to international trade and investment for SMEs

There are also obstacles to international trade and investment within European companies. This is particularly true of SMEs. While our trading partners also have large SME sectors, there are indications that American hi-tech SMEs and Japanese SMEs clustered around *zaibatsu* are more active internationally. It is estimated that less than 10% of the Union's SMEs are involved in exporting and foreign investment outside Europe.

European SMEs need:

- **better information about foreign markets**, market opportunities, distribution channels, contacts and networks, involving clusters with larger companies;
- **better skills and management competencies**, including an ability to manage international sales and logistics, understanding of overseas markets, competence in financing overseas trade and managing foreign exchange risks, as well as language skills;
- **more financial resources**, such as capital to fund additional inventories and long-term foreign exchange debtors, balance sheet strength to absorb foreign exchange and bad debt risks, and an ability to provide finance to buyers.

Many programmes have been developed in recent years by Member States and the Commission to assist SMEs to overcome these obstacles. However, for the most part, they seem inadequately focused and integrated to be effective.

The CAG recommends that action be taken by the European Union, Member States, business associations and companies, as appropriate, to:

- **benchmark existing programmes designed to assist SMEs to improve their international performance and transfer best practice between Member States;**
- **increase the number of co-operation agreements between Europe and the rest of the world, particularly in research and technological development;**
- **increase the number of collaborative deals between research bodies and SMEs, particularly on technology applications;**
- **encourage co-operation between SMEs and large companies, particularly on exporting, foreign investment and shared access to R&D resources;**

Our **key benchmark** is "the percentage of SMEs participating in extra-EU trade".

The context: social and environmental standards

In a globalising world, differences in social and environmental standards will exist between competing producers of goods and services. Trade restrictions should not be used to compensate firms for the cost of higher standards than those governing their foreign competitors, particularly in developing countries. Global integration helps developing countries create the conditions for economic growth and improved living standards also by making the most of their initial comparative advantage of a low-wage labour force.

Nevertheless, the international community has the right to concern itself with respect for the basic human rights of people at work and with respect for the environment, especially for the global commons.

International Labour Organisation conventions define a set of core labour standards which help provide the social context for international trade. These are:

- **prohibition of forced labour;**
- **elimination of exploitative forms of child labour;**
- **freedom of association and collective bargaining;**
- **non-discrimination in employment.**

In the same fashion, Multilateral Environmental Agreements form a core of international environmental law, translating into practice our fundamental obligation to conserve, protect and restore the health and integrity of the Earth's ecosystem.

The link between trade and environmental and labour standards is already evident in international agreements. It is now increasingly being found in private sector codes of conduct, in eco-labelling and social labelling. It will have significant impact on trade. The CAG believes that, besides action at the international level, positive incentives and private sector initiatives must play their full role.

The CAG recommends that:

- **the European Union work to ensure, through the ILO and the WTO, clear, predictable and fair rules for the use of trade measures in the areas of labour and environmental standards;**
- **financial and technical support programmes for companies in developing countries to reduce the environmental impact of their activities in cost-effective ways be established by the Union;**
- **the Union encourage the adoption by firms of codes of conduct relating to labour and environmental standards, extending to subsidiaries and to suppliers.**

Attitudinal barriers

There are attitudinal barriers in Europe to international trade and investment. One explanation is shortcomings in the educational process:

- **a failure to imbue positive attitudes towards international trade and investment** into young people as they enter the work force;
- **a failure to attract foreign students and teachers to study and work in Europe**, and to encourage European students and teachers to study overseas - particularly in Asia. For example, Europe attracts only one-fifth of the students from the fast-growing Asian economies who are studying outside the region.

Real benefits arise from significant levels of student exchange. These include: better understanding of different cultures, languages and lifestyles; access to new ideas, research perspectives and skills; freshly forged links and networks between Europe and its markets, present and future. Numerous examples of successful programmes to facilitate international student exchange exist. We should learn from them.

- The prestigious **Fulbright Programme** has facilitated student and teacher exchanges between the USA and 140 countries over the last 50 years. 120,000 foreign students have studied in the US, 90,000 Americans have studied overseas.
- **NORLET** is a smaller-scale programme, designed to provide leadership and executive training to Russian managers. Established by seven major Scandinavian companies, NORLET aims to address one of the most serious problems for foreign investors in Central and Eastern Europe - the poor quality of local managerial skills. Financed through public-private partnership, the programme has successfully trained 600 Russian managers. It has now been extended for a second 3 year term.

The CAG **recommends** that action be taken at the level of the EU and the Member States, as appropriate, to:

- **increase the number of exchange programmes for students and teachers with the Union's major trading partners;**
- **adapt programmes better to meet the needs both of foreign students and of European companies involved in international trade and investment;**
- **improve the marketing of Europe's higher education facilities to students outside Europe.**

Our key **benchmark** is an 'Asian student exchange index' (that is, the number of Asian/European student exchanges compared to the number of Asian/US exchanges).

III. HIGH LEVEL STANDARDS, HIGH LEVEL BENCHMARKS

Globalisation is creating new opportunities for greater efficiency in production and higher standards of living. At the same time, new mechanisms may be needed to ensure fair distribution of the gains and protection of basic values. Some of these mechanisms will be within the nation state; others will require countries to act at regional or even world level.

Generation of new wealth is the cornerstone of all our future prosperity. In Europe, we are perhaps more aware than elsewhere that the distributional consequences for those negatively affected - who have to make way for new products and ways of doing things, who lack the right skills or who have no capital - can be painful. Policies at national and European level should not only aim to succour those hurt by change, but also to make change less unwelcome by encouraging continuous adaptation.

The key to solving Europe's problems of growth and employment are primarily to be found within Europe itself. The CAG believes that the European Union has an important role to play in industrial/regional adjustment to external competition. By insisting on compliance with market opening obligations, both in the Single Market and at world level, the Union can avoid the risk that European societies take the easy but ultimately self-destructive route of resisting change. European competition policy, especially concerning state aids, also serves that purpose.

At the same time, the Union has at its disposal, through the structural funds, an important instrument of adjustment to external competition. The CAG urges that the existing distribution of resources be changed: less resources for measures taken after the event in response to crisis, more resources for forward-looking adjustment and prevention, including measures to improve the functioning of the labour market.

For the CAG, the core of European regulations, those intended for the protection of workers' health, consumer safety and the environment, provide the context in which we work. They can be seen as determinants of costs, almost in the same way as natural resource endowment or levels of technology. Trends in European trade and industry will reflect these standards, for example less pollution-intensive industries, more high-quality production. One aspect of our role in global trade is to raise awareness of the value of these standards for all economies as they achieve our levels of prosperity.

From the departure point of these standards, and as part of an ongoing effort to enhance the returns from globalisation to the European economy, **the CAG recommends** that high-level benchmarks be developed, with associated targets, to monitor Europe's place in the process of internationalisation.

Our **key benchmarks** here are:

- **Europe's share of world trade, relative to those of Japan and the USA;**
- **Europe's share of extra-EU Foreign Direct Investment (inward and outward), relative to Japan and the USA;**
- **Europe's share of Asian markets, relative to Japan and the USA;**
- **Europe's share of hi-tech markets, relative to Japan and the USA.**

The CAG further recommends that the European Commission should:

- **present all the benchmarks and the appropriate targets to the June 1997 meeting of the Heads of State and of Government;**
- **report on progress to the Heads of State and of Government on an annual basis.**