

INSIDE THIS ISSUE

Who speaks for the European Union?

by Malcolm Subhan

Well, who does? Henry Kissinger, in that thrice-told tale, famously wanted to know the number to call when he wanted to speak to the person running the European Community. The present Secretary of State, Colin Powell, can always call the European Union's High Representative for Common Foreign and Security Policy, Javier Solana, and the European Commissioner for External Relations, Chris Patten. The White House certainly has the number of the current holder of the EU's rotating presidency, while the leaders of the two Houses of Congress know where to reach Pat Cox, who heads the European Parliament.

There is clearly no shortage of official channels of communication across the Atlantic. Nor across Asia. Meetings between European and Asian presidents and prime ministers are an annual event, with no fewer than 25 of these worthies coming together every two years in a display of solidarity, modestly entitled the Asia-Europe Meeting (ASEM). Their foreign ministers can be glimpsed moving between the various Asian and European capitals, while meetings between their officials, such as the cryptically designated SOMs, are too numerous for anyone to keep track of.

All this to-ing and fro-ing serves a useful purpose. But it has tended to overshadow another set of meetings, those between representatives of European and Asian civil society. Of course there are not many such meetings. Which is rather surprising, given that European civil society has had a role in the decision-making process since 1958, through the European Economic and Social Committee (EESC). The main purpose of this consultative body, which brings together representatives of economic, social and civic organisations, is to advise the three key Brussels-based EU institutions – the Council of Ministers, the European Commission and the European Parliament.

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Representatives of European and Asian civil society organisations do meet each other on their own, of course. They come together during the EU-Asia summit meetings, for example, in an attempt to upset the even tenor of those meetings. But given the strength and diversity of civil society organisations, in Europe as well as Asia, their voices must be heard by European and Asian decision-makers. Not as voices off, but as part of the official debate on key issues in EU-Asia relations.

There is the obvious danger that if you include civil society organisations in the decision-shaping process, they will become part of the Establishment. The European Trade Commissioner, Pascal Lamy, may have pointed the way recently, when he travelled to New Delhi to speak at the 20th anniversary celebrations of a well-known Indian non-governmental organisation, the Consumer Unity and Trust Society. CUTS has brought together European and Indian economists to prepare working papers on issues that are on the agenda of the ministerial meeting of the World Trade Organisation (WTO), to be held in Cancun, Mexico, in September. These papers are aimed expressly at Mr. Lamy and the Indian Commerce Minister, not at other academics.

The EU-India Round Table was perhaps the first successful attempt to bring civil society into the official, decision-shaping process. It was conceived by a former Indian foreign minister, who persuaded Commissioner Patten to support it. The decision to set up the Round Table was taken at the first EU-India Summit, held in Lisbon in 2000. The Round Table met for the first time in January, 2001, in New Delhi. It held its fifth meeting in Bangalore in March, 2003. This is a remarkable achievement in itself. The no less important EU-India Think Tank Network has yet to see the light of day, although it, too, was given the go-ahead by the Lisbon Summit.

The membership of the Round Table is broadly representative of organised Indian and European civil society. Its 15 European members are drawn from the ranks of the Economic and Social Committee, as proposed by Commissioner Patten. The Indian members are drawn from business organisations, a trade union, academia, the media and non-governmental organisations. In the long-established Indian tradition of round tables, they are eminent persons as much as representatives of the organisations they come from. Their numbers therefore include a retired diplomat and a retired civil servant.

Under its Terms of Reference, drawn up by officials at a meeting of the Indian and EU foreign ministers, enjoys "the privilege of having direct access to the highest level of Government/EU institutions." Its specific recommendations are "non-binding" inputs

"for decision-making by the Government of India and the European Institutions." And this seems to be happening. The EU-India Summit, held in Copenhagen in October, 2002, welcomed the "considerable progress achieved in enhancing a dialogue between civil societies and ...the recommendations of the 4th meeting of the EU-India Round Table." Its Agenda for Action called for the mobilisation of the "resources needed to promote autonomous civil society interaction" and the preparation of "a joint report on the appropriate follow-up to the recommendations tabled by the EU-India Round Table," for the New Delhi Summit in November 2003.

One of the recommendations to the New Delhi Summit is for the setting up of an EU-India civil society Forum on the Internet. The Forum will make it possible for the broad spectrum of European and Indian civil society organisations to contribute to the discussions taking place at the Round Table. Their input should ensure that its recommendations are based on a broad range of opinion and experience, thus adding to their credibility and effectiveness.

"There is now a broad consensus in favour of extending the concept of international relations from relations between states to relations between their respective societies. The new players on the international relations scene, namely representatives of civil society organisations, are therefore being called upon to play a vital and growing role in backing up the role played by the traditional players in the field of international relations. In this context, our Round Table has a vital role to play."

Roger Briesch, co-chairman of the EU-India Round Table and President of the EESC, speaking at the fifth meeting of the Round Table, held in Bangalore, India, on March 8-10.

Inaugurating the Round Table in New Delhi, the then Indian Foreign Minister, Jaswant Singh, urged its members to act "free of the confines of officialdom." Commissioner Chris Patten reminded them that "civil society has a very valuable advantage: it can discuss all issues, even those considered 'sensitive' by politicians. Since then the Round Table has embarked on a constructive dialogue on sensitive issues. At its Bangalore session it discussed human rights in the workplace, for example, and has undertaken to return to the subject at its next session.

The EU-India Round Table is likely to result in similar Round Tables with other Asian countries. The EESC has already contacted with the Chinese Social and Economic Council; similar initiatives may well follow. ■

EU-India CSP a disappointment

by Pushpendra

The EU-India Country Strategy Paper (CSP), 2002-2006, is a classic example of the rhetoric and duality in the European Union's approach towards developing countries. I have three basic problems with the paper. They are problems of diagnosis, prescription and incoherence.

Diagnostic Problems

The paper states that the overall objective of EU co-operation with India is to support the official policy aimed at reducing poverty by half within the decade, with particular emphasis on social and economic reform, improved governance and sustainable development. The EU's diagnosis of the prevailing high levels of mass poverty in India has umbilical links to the neo-liberal paradigm. It sees the core of the problem to be the persistent large fiscal deficits of the Central and state governments. The paper also points to such additional factors as a narrow base for direct taxation, an unreformed civil service, a high degree of government intervention in agriculture and a relatively high degree of protectionism, which has resulted in India's insignificant share in global trade.

In essence, the factors related to macroeconomic stabilisation and supply side reforms have been identified as the causes of poverty. The paper overlooks the vast body of literature which shows poverty in India to be structural, and linked to a gross denial of the basic economic and social rights of the poor. Extreme inequality exists in economic as well as social life. The distribution of economic resources is highly skewed, while the continued practice of untouchability and political discrimination against the *dalits* (untouchables) has contributed to their marginalisation.

Through the exercise of eminent domain, the State has taken away the land, forest and other natural resources of poor people, particularly the tribals and the *dalits*. To be exact, the Indian state suffers from a lack of accountability towards its poor and marginalised, and also fails to create space for their effective participation. Macroeconomic stabilisation and supply side reforms within the framework of liberalisation may generate wealth in theory, but without helping the poor.

Prescriptive Problems

The neo-liberal solution follows from its own diagnosis. It includes controlling the fiscal deficit (in practice, a reduction in government expenditure), liberalising trade, fiscal restructuring, increasing public sector efficiency, and reducing the role of the state in agriculture, industry, transport and energy. These measures, it is argued, will lead to the 10% growth rate that is needed to substantially reduce poverty within a decade. I do not intend to enter into the debate on liberalisation and structural adjustment programmes, as so much has been written on this subject.

A recent study by the International Monetary Fund (IMF) accepts that there is no clear evidence to suggest that liberalisation helps the poor. My purpose is to show that the EU's prescriptions, particularly the specific programmes proposed under its co-operation programme with India, are inconsistent with a vision of a market economy that is based on greater equality, uses the power of markets to bring prosperity to all members of society, and is not just concerned with the pace of growth.

The EU's co-operation programme identifies elementary education, basic health, environment (as a cross-cutting component) and fostering an enabling economic environment (under an agenda of improved governance) as strategic areas of co-operation. While welcoming the EU's support to the social sector, I must voice my concern over the lopsided emphasis the paper puts on promoting an enabling economic environment. The EU offers to share its experience in improving systems of economic governance, and assist India in its efforts to integrate its economy regionally and with the global economy.

To this end it proposes a special Trade and Investment Development Programme, which builds on the industry-driven "EU India investment and trade enhancement initiative." Under this programme the EU will help India develop its tariff, tax and regulatory infrastructure; train the civil service and industry on multilateral trade and the WTO; promote industry-driven studies on trade and investment, etc. The EU further offers to support sector-specific economic co-operation, including co-operation in the area of statistics, provided it is driven by the private sector and addresses the underlying policy environment.

I wish the EU could have offered instead to share its experience of social security systems in its member countries. This is of far greater relevance to countries like India, which can learn a lot from the experience of EU member states in running a plethora of social security schemes. Belgium, for example, has old age, disability and survivor pensions; sickness and maternity benefits; workers' medical benefits; dependants' medical benefits; unemployment benefits



(aged unemployment supplement, job search benefit, pre-pension supplement, and supplementary subsistence benefit); family allowances and so on. These social security schemes ensure that no one is left unattended in case of need. In practical terms this ensures that no one dies of starvation, or lack of treatment or inaccessibility to medicine.

The drugs needed to treat a common disease like malaria cost roughly €0.30 in India under normal conditions; even so, many poor people cannot afford them. A sizeable section of the Indian population, particularly in backward states, does not seek medical treatment, either because it is not available or is too expensive, according to recent rounds of the National Sample Survey (NSS).

As Prof. Jean Dreze has pointed out, all Western countries, with the partial exception of the United States, have highly socialised systems of health care and education. It is an interesting paradox that many Western governments advocate the privatisation of social services in poor countries, even as they consolidate their own socialised arrangements at home. In fact, the global world order, dominated by the Western countries, has made it harder for a country like India to develop socialised systems of health care and elementary education.

On health sector reforms, the EU has chosen to follow the 'reductionist' model of reproductive and child health (RCH), rather than a comprehensive primary health care model as envisaged by the Alma Ata Declaration of 1978. The former is in line with a policy of reducing state expenditure on health care and charging user fees. The EU-India Country Strategy paper follows the approach of the World Bank (*World Development Report, 1993: Investing in Health*), while arguing that "working with and through non-governmental organisations (NGOs), and exploring public-private partnerships, is critical to assuring quality of delivery in light of the growing trend towards private sector driven provision of education and health services". However, National Sample Survey data show a high degree of dependence on public health institutions for curative services across most Indian states, particularly the bottom 20 per cent. NGOs and the private sector are skewed in favour of urban and better-developed states.

It is clear from a study by Dr. Rama V. Baru that what these two sectors mainly provide is outpatient care. In some of the states where there has been significant growth of the private sector, these services are at best supplementing public services. The gap left by the cutback in public services will not be immediately filled by the private and voluntary sectors; they will move only into those areas where they can show results/profits. Any cutback in public services will thus only exacerbate the existing disparities of access in

terms of rural-urban differentials, advanced and backward areas and across classes.

Aside from social security schemes, a study of the role of the state in EU countries in maintaining the basic infrastructure, including basic services like water supply, sanitation, etc., can be a rich source of learning for countries like India.

Problems of incoherence

According to the EU India strategy paper, the EU's co-operation strategy is fully coherent, as it links issues of poverty, sustainable economic growth and enhanced trade. The actions proposed are in line with the key objective of EU trade policy of promoting the integration of developing countries into the multilateral trading system, which is based on open markets. The EU has undertaken to work closely with the World Bank and the Asian Development Bank in policy areas where they have the leverage to induce change.

I cannot resist pointing out the strong similarities between the EU-India Country Strategy Paper and the World Bank's Country Assistance Strategy Paper. The EU-India paper also promises to take into account the disparities between India's economically vibrant south and west and the less dynamic areas in the north, centre and east. It also speaks of empowering the most vulnerable sections of the population, and helping women and the socially marginalised participate in the design and execution of programmes.

However, much of this does not match the proposed programmes. For example, rather than focusing on supporting the development efforts of the backward states in the north, centre and east India, the EU proposes using most of the (remaining) resources for the next five years in a comprehensive "partnership for progress" with a *reform-minded* Indian state. The purpose is to facilitate dialogue on vital cross-cutting issues of governance, including fiscal and economic reform, transparency in decision-making and devolution of powers to the stakeholders.

It strategy paper should also have identified the poorest and the most marginalised communities. They include the homeless, disabled, widows, landless agricultural labourers, child labourers, *dalits* and poor tribals, and nomadic and semi-nomadic communities. The governance agenda of the EU-India co-operation programme should have aimed at improving the capacity of the central and state governments to serve these communities better by being accountable to them, creating space for their participation, and doing away with laws that are anti-poor in nature.

Finally, a glaring incoherence in the EU's policies stems from the fact that it grants its farmers some of the highest subsidies in the world, and yet has sided



with the World Bank and IMF by suggesting that developing countries eliminate their subsidies, as a pill against poverty. The strategy paper has criticised India's agricultural subsidy, though in its proposals for reforming the common agricultural policy, and in its submission in the modalities negotiations on agriculture in the WTO, the EU proposes to continue granting its farmers substantial export and domestic subsidies (whether in the amber, blue or green boxes). This will allow them to continue to sell at less than the cost of production, and exporters to dump low-priced products onto the world market, and particularly in developing countries. What is sweet for EU countries is bitter for India! ■

Pushpendra is the Regional Manager in the Patna Regional office of the development NGO ActionAid India. He is currently based in the ActionAid Alliance's Brussels office as Food Rights Policy Officer.

Local Government in India and China: Learning from each other

by George Mathews

The implementation of socialist democracy in China has made definite strides at the village level. Villagers' Committees are the organs of self-government for China's rural areas, where more than 70% of the population lives. These committees are non-governmental, and their relations with the lowest tier of government, townships, has grey areas. More than 600 million rural voters have taken part in the elections to the villagers' committees in the last 10 years.

In India, too, some 70% of the population lives in rural areas. Here the panchayats, or village councils, are statutory bodies. The Indian Constitution was amended 10 years ago to make the panchayats and municipalities constitutional bodies at the district level and below, a move that was hailed as "historic" and a "silent revolution."

The development of villagers' committees

The very first villagers' committee in China came into being in 1980, in a poverty-stricken village in Guangxi Zhuang Autonomous Region. The local government reportedly got wind of what had happened in Hezhai village, and sent officials to

investigate. Their findings were sent to China's highest authorities, and in 1982 the "villagers' committee" was entered in the revised Constitution of the People's Republic of China. It thus became a legal entity, although there was no law concerning its organisation and functions.

In 1987 the Standing Committee of the National People's Congress adopted the Organic Law of the Villagers' Committees for trial implementation. By the end of that year, committees had been set up in 14,737 former "production brigades" in the Guangxi Zhuang Autonomous Region, giving autonomy to 5.8 million former commune members. Thus the eclipse of the people's communes and the production brigade paved the way for village democracy. By the early 1990s the central authorities had resolved to improve and enhance social democracy, besides going ahead with economic reforms. The 1998 Organic Law on the Villagers' Committee defined these committees as "a self-governance organisation at the grassroots level for villagers' self-management, self-education and self-service."

Studies of villagers' committees in the last 10 years have described their achievements. Committee members are chosen through direct, multi-candidate elections, although 70% of them belong to the Communist Party. Even so, ordinary people, who have never experienced democracy, participate in election meetings, vote and even run for office.

My visit to Beizhuangtou village, 50 kms. from Beijing, in November 2002, was an eye opener. Guan Rong, a farmer, makes a net profit of 100,000 yuan a year. His wife has a shop selling vegetables and sweets. Their 21-year old is in a boarding school. They live in a well-built, spacious house, like the other 200 households. He took me to the villagers' committee office, which is next to the Communist Party office. All three committee members are Party members.

I was particularly attracted to the school, which has 17 students, in the age group of 3 to 6 years. The one-child norm is strictly observed in this village, which has a population of about 600. The school is not managed by the villagers' committee, but is a private initiative, run by Liu Yang Rong, who charges an annual fee of 500 yuan per student. Her husband runs a paint manufacturing unit near the village.

Indian local self-government

The first draft of India's Constitution did not include a provision for the establishment of panchayats, in spite of their history, the nationalist movement's commitment to them, and Mahatma Gandhi's unequivocal propagation of the ideal. The Gandhians



considered panchayats a means as well as an end, and sincerely believed in their immense potential for democratic decentralisation. But these village councils were not given the constitutional status and recognition they deserved, because both urban and rural elites, and their political representatives, had a disdain for panchayats, which has remained intact.

Although state governments were not compelled to set up panchayati raj in the absence of a constitutional man-date, some States like Maharashtra, Gujarat, West Bengal, Karnataka and Andhra Pradesh, did so as far as they could. However, Karnataka's panchayati raj minister declared in 1985 that "our efforts may not be as fruitful as we desire, without a constitutional amendment." He called for a public debate on the need for such an amendment. However, it was not until 1992 that the amendments relating to panchayats and municipalities were adopted by both houses of the Indian Parliament, and came into force the following year.

The amendments defined panchayats and municipalities as "institutions of self-government." Village assemblies, or grand sabhas, comprising all adults registered as voters became basic units of the democratic system. In all states with a population of over two million, the panchayats have a 3-tier system at village, intermediate (block/taluk) and district levels. All members are chosen by direct election, with not less than one-third of the total number of seats, and one-third of chairpersons, being reserved for women. Indeed, of the three million representatives elected every five year through the democratic process, more than one million are women.

Under the two constitutional amendments, each state has an independent Election Commission for superintendence, direction and control of the electoral process and preparation of electoral rolls. Panchayats prepare plans for economic development and social justice covering as many as 29 subjects. The plans prepared by panchayats and municipalities are consolidated by a District Planning Committee. A Finance Committee in each state decides the principles which ensure that panchayats and municipalities have adequate financial resources, which include grants from state and central governments and the revenue from certain taxes collected and retained by them.

The most fundamental change that has come about in Indian democracy is the widening of the democratic base of the Indian polity. Before the Amendments, the country's democratic structure, through elected representatives, was restricted to the two Houses of Parliament, 28 State assemblies and the two assemblies of Union Territories (Delhi and Pondicherry). They had just 4,963 elected members, whereas today some

three million representatives are elected by the people through the democratic process.

The initial 10-year period in local self-government has not been altogether disappointing, given the severe social and political constraints within which it has had to function. They include social inequality, the caste system, patriarchy, a feudal setting, illiteracy and uneven developments. Elections every five years to the local self-government institutions are the norm today, although in the early years almost all the states, irrespective of the political party in power, defied the constitutional provisions with all the power at their command. Their efforts were resisted, however, by civil society organisations, which filed public interest litigations, with the result that the judiciary intervened effectively at different levels.

Ten years is a short time span. But they have witnessed steady progress as regards the inclusion, in the decision making process from village to district level, of excluded sections of the population. The fact that more than one million women are elected to these bodies is no mean achievement in a hierarchical and male-dominated society like ours. The common refrain, that it is the menfolk in the families who control the women elected members, may be partly true, but studies show that the situation is rapidly changing. What is more, patronage and clientelism are slowly shifting from traditional castes and families to political parties and ideologies.

The panchayats have not worked wonders, but a small beginning has been made, despite the efforts of members of Parliament (MPs) and of the Legislative Assemblies (MLAs) to undermine them. It is an irony of sorts that the very hands which created the new panchayats and municipalities are now trying to prevent them from blossoming into institutions of self-government.

Common issues for India and China

The centralisation of authority has a tendency to persist in both China and India. Party and government officials in China looked with scepticism on the self-government exercised by the "poorly educated" rural population. "Village offices," agencies of township governments, were set up, to replace villagers' committees, until the central authorities intervened decisively in 1993. By the first half of 2001, the last of the village offices was closed down.

All the doubts and suspicions of Party and government officials about local self-government in China apply to India also. Here, vertical authority through line departments is the reality. But decisive intervention by the Central government, as happened in China, is lacking in India. Centralisation is convenient for politicians and the bureaucracy.



Violence

Studies of elections in China has brought to light abuse, criminal activities and violence in some localities, perpetrated by rich villagers or clans, party cadres, village leaders and entrepreneurs. The clan problem is rarely discussed in detail. Most provinces simply refer to the “disturbing” influence of clans and family groups. Elections exacerbate the accumulated grievances that exist between clans or factions, resulting in violence.

In India violence during and after the elections are common. In the six-phase panchayat elections held in the state of Bihar in April 2001, some 96 persons including a magistrate and several candidates, lost their lives. Bloodshed, dishonouring women, torturing lower caste people, abusing the posts held by the poorer and weaker sections of society are common in the panchayats and even in town municipalities.

Corruption

During my visit to Shanyong and Lioning provinces in 1992 and 1993, I was repeatedly told there was no corruption. Strict economic control reduced the chances of corruption at that time. When I visited Beizhuangtou village in early November 2002, a farmer, Guan Rong, stated that corruption is a major issue. It was a major concern in the recently concluded 16th National Congress of the Communist Party.

In India, corruption at the local self-government level is of utmost concern. Some have described it as the de-centralisation of corruption. The unholy nexus of politician-official-contractor is the main cause of the perpetuation of corruption. Several mechanisms are in place to check corruption at the panchayat and municipal levels; but corruption is systemic and cannot be dealt with segmentally.

Women's participation

Chinese society, like its Indian counterpart, has a long way to go when it comes to the status of women. In China, there is no reservation for women in elected bodies. In the villagers' committees there are just one or two women representatives, as a goodwill gesture and not as of right. There is only one vote for the household in China, and it goes without saying this vote is exercised by a male member of the household.

The absence of women's participation in sizeable numbers in villagers' committees is a major concern of many groups in China. Many groups and senior government officials I interacted with consider India as a role model for China. Although not less than one-third of all seats are reserved for women in India,

several women have been elected from unreserved seats. Thus in several states more than one-third of the seats in the panchayats have gone to women. This will be the case in Parliament and the State Assemblies also in the not too distant future.

Democratic norms

An ideal democratic election requires four steps: an open nominating process; the opportunity to share views with the voters through election campaigns; secret voting, and the strict monitoring of ballots and counting. In a paper presented at an international symposium in Beijing on villager self-government in China, its authors concluded that “most village elections allow for one or two of these steps. Some allow for all four. But in every reported case, the Party at some level retains some control over the outcome of elections” (Robert Gamer and Huisheng Shou).

Although India, with a long democratic election history, observes all four norms, both capturing, manipulations, etc. have not totally disappeared. Some states are very vulnerable in this respect in fact. However, the Election Commissions at the Centre and the States, a multiparty system and increasing political and democratic awareness are curbing these tendencies.

One thing stands out. The basic level democracy, with which China is struggling, will have far-reaching consequences for China's democratic structure. It may even go beyond everyone's expectations, even those of the Party leadership. Meanwhile, both China and India have a lot to learn from each other, whether in the field of local democracy, women's participation, economic development or combating corruption. ■

George Mathews is the Director, Institute of Social Sciences, 8, Nelson Mandela Road, New Delhi 110070, India. Email: issnd@vsnl.com Dr. Mathew's study of Villagers' Committees in China in November 2002, was made possible through a grant from The Ford Foundation, New Delhi.

EU-Iran relations

by Nawab Khan

After nearly two decades of ups and downs, relations between the European Union (EU) and Iran are now on the path of stabilisation. Developments in the last two years show both sides determined to cement their economic and political ties, in the wake of the reformist and democratic agenda pursued by the administration of President Mohammad Khatami. Although a dialogue between the EU and Iran was launched in 1995, it is only now that Brussels and Tehran have taken practical steps to put their bilateral relations and co-operation in a contractual framework.

The European Commission approved on 19 November 2001 a proposal to begin negotiations with Iran on a co-operation and trade agreement, alongside a political dialogue covering issues such as human rights, the fight against terrorism, nuclear non-proliferation and the Palestinian conflict.

The EU Council of Ministers gave the European Commission a mandate on 17 June 2002 to open negotiations, and the groundbreaking talks began in December 2002. Two rounds of talks have already taken place, and the third will be held in April.

The turning point in relations between Iran and the EU came with the visit of Dr. Kamal Kharrazi, the first by an Iranian foreign minister, to Brussels in September 2001. Since then there has been a flurry of diplomatic contacts, with top EU officials, including the foreign policy chief Javier Solana and Commissioner Chris Patten, visiting Tehran in order to promote closer ties and co-ordinate positions on issues of common interest.

The rapprochement with Iran received further impetus from the first-ever visit by a delegation from the European Parliament to the Islamic Republic in the summer of 2002. Kamal Kharrazi addressed the European Parliament in Brussels in February 2003, the first foreign minister of the Islamic Republic to do so.

Analysts in Brussels and Tehran have described these events as the most important developments in relations between Iran and Europe since the establishment of the Islamic Republic in Iran in 1979. Both sides appear determined to cement their new relationship. President Khatami has paid highly successful visits to six EU countries, and is expected to visit Belgium later this year.

For the EU, Iran's economic potential and its geo-strategic position clearly are too important to be ignored. Moreover, the commercial vacuum left by the United States, after it disallowed American companies

to invest in Iran, has been filled by European companies.

The EU is Iran's main trading partner, as regards both imports and exports, according to a European Commission report. EU imports from Iran totalled €6.7 billion in 2001, while its exports to Iran amounted to €6.6 billion in the same year. Whereas more than 80% of EU imports from Iran consist of oil products, its exports to Iran are more diversified, with power generation plants, heavy machinery and electrical and mechanical appliances accounting for some 45% of the total.

A working group on energy was established in May, 1999, and the European Commission last year opened an energy bureau in Tehran, in order to expand energy co-operation. Iran possesses some 10% of the world's oil reserves and 16% of its natural gas reserves. Better relations with Iran would guarantee a constant and stable supply of energy for the EU economy.

Iran, for its part, is trying to rally EU support for reviving the country's application for WTO membership, which was submitted over three years ago and blocked by the United States. The fight against drug trafficking is another important area of co-operation between the EU and Iran, given the fact that large quantities of drugs are smuggled from Afghanistan to the European market via Iran.

European observers are keen to point out that the 15-member European bloc is proceeding in earnest with its engagement and dialogue with Iran, despite strong American criticism. Washington was taken aback by the widespread condemnation in Europe of George W. Bush's assertion that Iran, too, is a part of the "axis of evil." European officials maintain that the U.S. President's rhetoric, which is viewed as out of place, is damaging the cause of the reformist camp in Iran. The EU has been stressing Iran's vital role for peace, stability and security in Afghanistan and the wider region, in sharp contrast to Washington's accusations that Iran is a destabilising factor and a sponsor of international terrorism.

The Iranian government's spokesman, Abdollah Ramezanzadeh, has pointed out that the EU and Iran are determined to develop their ties, regardless of what "third parties might think." In two further significant moves to soothe Tehran, the EU declared the Iraq-based Iranian Mujahideen Khalq Organisation (MKO) a terrorist group in May, 2002, and decided not to table a resolution in the UN, criticising the human rights situation in Iran.

However, no one expects the EU-Iranian rapprochement to proceed smoothly. There are wide differences in perception on issues such as human rights (the death sentence, women's rights) and the



Israeli-Palestinian conflict. It appears, however, that the two sides are not looking for tangible results overnight. Their approach is a long-term one, based on step-by-step development.

On pre-war Iraq, Iran shared the view of the majority of EU member states – that the UN must resolve the crisis and American unilateral action has to be avoided. The position of the two sides regarding post-war Iraq is also identical, in that both believe that the UN must play the central role. In the wake of the invasion of Iraq by American-led forces, in stark violation of the UN charter, both the EU and Iran are even more concerned about US intentions in the region. Co-operation between the EU and Iran is expected, therefore, to grow once post-war developments unfold in Iraq. ■

Nawab Khan is the Brussels-based correspondent for the Islamic Republic News Agency (IRNA), in Iran.

ALA Regulation proposal likely to be rejected

The future of the European Commission's proposal to provide a new legal framework for development co-operation with Asia and Latin America has been thrown into serious doubt. After a series of meetings in the European Parliament, it is clear that many of its members question the logic of having a single Regulation covering both continents. Any delay would mean that a new legal framework could not be adopted before the end of 2004.

The present Asia and Latin America (ALA) Regulation was adopted in 1992, and governs the provision of development aid by the European Union to the countries in both continents. The European Commission's proposal for a new legal framework seeks to replace the project-by-project approach to development assistance with multi-annual programming. The new Regulation would establish "clear and simple rules" instead of offering "political or strategic" guidelines, as is the case at present.

The Commission's review of the current ALA Regulation has been discussed by MEPs in the Development and Co-operation Committee and Foreign Affairs Committee. The Dutch Liberal MEP, Mrs Marieke Sanders-Ten Holte, who is writing Parliament's report on the proposal, has yet to decide whether to reject the Commission proposal or to follow in the steps of the Industry Committee which, several years ago, split the Commission's draft electricity and gas directive into two.

The revolt against the ALA proposal is being led mainly by Spanish MEPs from both the main political groups. Mrs Francisca Saquillo, of the Socialist group, believes that the Commission has ignored Parliament's request for two separate regulations, made in November 2001. She pointed out that the Mediterranean (MEDA) and East European (TACIS) regions have their own regulations, and urged the Development Committee to reject the current proposal and ask the Commission to submit two new regulations.

Another Spanish Socialist, Mr Miguel Martínez Martínez, suggested that there were elements within the European Commission that favoured two separate regulations. He put the current situation down to "bureaucratic inertia" within the Commission, a view shared by José Salafranca, of the Christian Democrat group, and Pedro Marset Campos, a member of the United Left/Nordic Green group. Glyn Ford, a British Socialist, who is drafting the opinion of the Foreign Affairs Committee, took the view that the Commission wants a "lightweight regulation" with the details to be filled in later. He was against rejecting the Commission proposal, on the grounds that there was sufficient room for manoeuvre by splitting the proposal into two parts.

There have been suggestions of more sinister motives behind the campaign to reject the European Commission's ALA proposal. The draft Regulation envisages a total of €2.52 billion for Asia, as against just €1.27 billion for Latin America. The desire for a larger allocation for Latin America may be behind the attempt to postpone the adoption of a new legal framework. Clearly some politicians believe that because the current ALA regulation remains in force for some time to come, they can afford to throw down a political challenge to the European Commission. However, the fact remains that the current ALA regulation's provisions for "aid to uprooted people" is due to expire in December 2004.

The European Commission official in charge of the ALA file, Mr Willy Vandenberghe, took a strong line with Parliament, when he reminded MEPs that a delay in adopting the proposal before them seemed to fly in the face of Parliament's stated commitment to reform the management of the EU's external assistance. While Asia and Latin America were obviously very different from each other, this did not seem to justify the demand for two separate regulations. The Commission would use country strategy papers and national indicative programmes to pursue development co-operation in an "efficient and effective" manner within the framework of a single regulation. Two regulations would only double the size of the bureaucracy and hinder the reform of the management of external assistance.



The European Commission's proposal has also been under discussion in the Council of Ministers' working group on development co-operation. The Spanish government has indicated that it does not favour a single regulation. However, it appears that most of the other governments support the Commission.

The Commissioner for Development Co-operation, Poul Nielson, told Parliament that if the regulation were adopted, the new legal framework would provide the "rules the Commission must follow" in order to implement development co-operation. What it would not do would be to "fix political guidelines or specific co-operation strategies". Parliament is concerned, however, that the procedure proposed by the Commission would increase the role of unelected committees of experts in deciding policy.

Chaired by the European Commission, these committees are made up of representatives of the 15 national governments. Parliament plays no role and has very little opportunity to oversee their activities. Mrs Sanders-Ten Holte has pointed out that parliamentary scrutiny is "notably lacking" in the Commission's proposal. She is expected to announce the procedure to be followed by Parliament when the Development Committee reassembles in late May. ■

John Quigley

Slow but steady progress in ESDP

The publication of a report in the European Parliament on the development of a European Security and Defence Policy (ESDP) has given a controversial boost to identifying the "priorities and deficiencies" in the nature of common security for the European Union (EU). The report, by the French Christian Democrat, Philippe Morillon, has called for the expansion of the Petersberg tasks to include actions such as combating terrorism. The push for progress at the European level is driven in part by the realisation that America may be re-examining its priorities in the transatlantic alliance.

The development of the EU's security and defence policy dates back to 1999. The aim is to give the EU a military capability within the framework of the Petersberg tasks and the United Nations. These tasks, which were proposed in 1992, include humanitarian and peacekeeping activities and crisis management, and could include peace-making. They were incorporated into the Treaty of Amsterdam in 1999.

ESDP includes both military and civilian actions. The military side revolves around the Rapid Reaction

Force, which commits the 15 Member States to deploy 60,000 troops within 60 days and for up to one year. Civilian actions would involve operations with the police, the rule of law, civil protection and civilian administration.

The European Council again addressed the current weakness of the ESDP when it met in Brussels on March 20 and 21. The EU heads of state and government stressed that the "capacity of the EU" in ESDP must be "strengthened," but they did not announce any new initiatives. It seems that the development of ESDP was again held hostage to the failure to devise a common foreign policy, this time over Iraq.

The EU has begun, with a semblance of political will, to take the first steps in implementing actions under the ESDP, close to home. On January 1, the EU began its first-ever ESDP police mission in Bosnia and Herzegovina, taking over the existing UN operation. EU foreign ministers announced on March 18 that the EU would take over the military operation in Macedonia from NATO from the beginning of April, using NATO "assets and capabilities" for this purpose. Prospects for the deployment of EU troops outside Europe in the near future are remote, however, as the EU still lacks the strategic capabilities for a truly autonomous operation.

Philippe Morillon wants the EU to have the capability to "extend peace and stability" outside the territory of the EU. An example of this could be the transfer of the control of the International Security Assistance Force (ISAF) in Afghanistan into a NATO operation "under European command". While most of the ISAF forces are from the EU, the prospect of Turkey, who commanded ISAF until February, agreeing to such a proposal was rated as low. When Germany and the Netherlands took over from Ankara on February 10 for six months, the German Minister for Defence, Peter Struck, suggested that by August, the leadership of ISAF could be handed over to NATO.

The Morillon report also proposes extending the scope of the Petersberg tasks to include conflict prevention, joint disarmament operations, post-conflict stabilisation and combating terrorism.

Ever since the events of 11 September 2001, the ESDP has been slowly re-oriented to include the fight against international terrorism. Spain, as President of the European Council proposed, that the ESDP should have an "important role in the fight against terrorism". The Seville European Council in late June 2002, adopted a Declaration on the ESDP's contribution to the fight against terrorism. Spain noted that combating terrorism required a "global approach" to "prevent and contain regional conflicts".



The Declaration sets out several priority areas for the fight against terrorism by the EU. They include deepening the political dialogue with third countries to promote human rights and democracy as well as arms control. The prospect of the deployment of EU troops outside the EU on crisis management operations has raised concerns at the European Council that EU personnel could be subject to terrorist actions. The Declaration also requires the EU to “determine the military capabilities” needed to protect EU forces from terrorist attacks. A report prepared last December extended this condition to include using military capabilities to protect civil populations from terrorism.

Presenting his report to the Foreign Affairs Committee on March 25, Philippe Morillon, a retired army general, stated that, the EU that he believed in was not a “rival or vassal of the US” but “a partner”. If the transatlantic alliance is to prosper, the EU must be prepared to take on the “burden of leadership”.

The development of an effective EU capability in ESDP can only come about given sufficient political will on the part of the Member States and the creation of a common foreign policy. This does not appear imminent. The Commissioner for External Relations, Chris Patten, said on March 12 that the common foreign and security policy (CFSP) had “suffered a severe setback” when some Member States presented their national positions as EU policy. The High Representative for CFSP, Javier Solana, indicated that the CFSP risked becoming a casualty of the Iraq crisis if EU states did not “act in a constructive manner”. An updated report on progress with the ESDP is due to be considered at the next meeting of the European Council on June 20. ■

John Quigley

EU development co-operation and enlargement

A key European Commission official has confirmed what many non-governmental organisations (NGOs) had long feared. With the guaranteed timetable for the enlargement of the European Union (EU) from 15 to 25 Member States set for May 2004, Koos Richelle admitted that European the Commission “had not given sufficient consideration” to development co-operation in the accession negotiations. The problems to be overcome by the EU internally and by the acceding states themselves are huge.

In order to prepare themselves for entry into the EU, the governments of the Central and East European (CEEC) candidates countries have been integrating the *acquis communautaire* into their national legislation. They will therefore become eligible to implement fully

the development policy agreed in November, 2000, by the then French Presidency of the European Council. This set the central objective of Community action as the eradication of poverty.

As part of the effort to alleviate or eradicate poverty, a United Nations sponsored conference, held in Monterrey in March, 2002, discussed “financing for development”. The EU committed itself to increasing the EU average for development assistance to 0.39% of Gross National Product (GDP).

The likelihood of the CEEC countries meeting the 0.39% target by 2006 is particularly slim, given that that even some of the existing Member States are unable to meet it. Speaking in Berlin in early April, the Commissioner for Development and Humanitarian Aid, Poul Nielson, claimed that it “would be unreasonable for new members” to reach the target by 2006, a view echoed by the Polish Under Secretary of State, Tadeusz Kozek. When EU development ministers meet in May, they will discuss a report prepared by the European Commission on the degree of success of Member States in meeting that goal.

The existing development assistance programmes of the CEEC states focus on their near-abroad and the former Soviet republics in Central Asia. Apart from Poland and Hungary, very few of them have any relationship with countries elsewhere in Asia. It seems that they will not be encouraged immediately to expand beyond their neighbours. Commissioner Nielson indicated that it would be “natural for CEECs to argue for support for the Balkans, the Caucasus and Central Asia”. The Commission believes that just as Spain and Portugal offered a bridge to Latin America, the CEECs will offer a bridge to Europe’s new neighbours in the East.

In financial and political terms, development assistance is a low priority for the new acceding states. According to a Trialog study, completed in February 2002, the CEECs devote much less than one tenth of one percent to official development assistance. This reflects in part the low political importance accorded to development aid by the CEECs. Most future member states do not have a specific development agency, while some suffer from a lack of technical expertise.

Progress is being made, however. The Czech Republic had increased its development assistance budget from €11m to €34m by 2001. The government has established a development agency, Czech Aid, to co-ordinate all development policy actions, and has based it in the Ministry of Foreign Affairs. And by adopting a Foreign Aid Programme covering the years 2002-2007, the Czech government has switched from dispersed projects to multi-annual programming.

BOND, the London-based network of development NGOs, has estimated that the impact of 10 new states on the EU's development policy decision-making structures will mean "more strain on overstretched resources". Monica Press of BOND held that in the short term enlargement will have an "adverse effect on the quantity and quality of EU aid programmes and funding opportunities".

The European Commission is trying to address problems thrown up by the forthcoming enlargement, according to Koos Richelle, a director-general Commissioner Poul Nielson's administration. This includes investigating the impact on decision-making procedures, development priorities and budgetary questions. The review is also examining the potential impact on the EU's development partners.

Potential complications already identified include the extent to which the CEEC states are willing to untie aid. The European Commission adopted a Communication on tied aid in November 2002, calling on the EU and Member States to stop the restrictive practice of forcing aid recipients to buy goods and services from the donor country. Another problem, according to Koos Richelle, is limited awareness in CEEC states of such EU practices as performance based allocations, the poverty reduction strategy papers and the shift from project to sector of budget support.

Experts from the development co-operation and foreign affairs ministries of Austria, the Czech Republic, Hungary, Poland, Slovakia, Slovenia and the European Commission held a workshop in February on capacity building for development services. The workshop exposed "considerable differences" in capacity building and "administrative capabilities".

Members of the workshop felt that when EU Development Ministers meet in May, they may well adopt a statement on the role of candidate countries in EU development co-operation and on the prospects for increased coherence, co-ordination and complementarity. ■

John Quigley

EU and ASEAN seek to ease Korean tension

by David Fouquet

The leaders of the 15-nation European Union (EU) are seeking a diplomatic alternative to the escalating tension and confrontation between Pyongyang and Washington, over the issue of the proliferation of weapons of mass destruction. At their recent summit in Brussels, the EU heads of state or government agreed to call a special meeting of their Foreign Ministers, with Korean and Japanese participation, in order to discuss the North Korean issue, with the aim of avoiding a showdown between the United States and the Democratic People's Republic of Korea (DPRK), and a situation comparable to that in Iraq.

The surprise action by the 15 EU leaders followed a report by their Foreign and Security Policy High Representative, Javier Solana, on his recent unsuccessful attempt to meet the North Korean leader, Kim Jong Il, with a view to breaking the impasse over his country's plans to withdraw from the Nuclear Non-Proliferation Treaty and relaunch nuclear research programmes which have aroused international concern.

A senior Korean diplomat, who welcomed the EU initiative, nevertheless remarked that it came "like a bolt out of the blue," without advance preparation or consultation. Nor were there any reports of consultations about the timing and other preparations for the meeting, even in the days following the EU announcement. An EU source close to the process also stated that the decision was a "last-minute one." He added that the discussion lasted only minutes, and that the details of the follow-up had not been worked out. Even so, the meeting clearly will be part of an intensifying international effort on the issue.

The EU initiative came in the wake of other special missions to the DPRK, including a second visit by a UN envoy, Maurice Strong. It was followed a few days later by the decision of ASEAN Foreign Ministers, meeting in Malaysia, to send a mission to Pyongyang. Led by their Cambodian chair, it represented yet another attempt to follow up on hints of openness on the part of North Korean contacts at recent meetings. Glyn Ford, a Member of the European Parliament familiar with the issue, also visited Pyongyang in March. North Korea indicated a guarded welcome for his suggestion for a smaller international gathering, without some of the main rivals.

The meeting planned by the EU could seek an agreement to engage Kim Jong Il by the EU Greek Presidency and its Prime Minister, Kostas Simitis. An



earlier visit by the Greek Foreign Minister, George Papandreou, was called off because Kim maintained that he would only meet a head of state or government, as was the case during his meeting with the EU Swedish Presidency in 2001.

This EU initiative, as well as those by the South Korean Government and others, will be directed largely at heading off a further escalation of the crisis, by formulating plans for humanitarian, economic and energy assistance to the DPRK, as well as security guarantees, in an attempt to induce Pyongyang to revise its nuclear plans, thereby reducing the tension. A meeting on economic co-operation between North and South Korea, to be held at official level on March 25, was cancelled by Pyongyang because of the outbreak of the war in Iraq, coupled with the announcement that South Korean forces were being placed on alert. However, a ministerial-level discussion between the two sides was also planned for early April, for which Seoul wants to prepare compelling measures.

In the meantime, the EU, the US and Japan resumed food deliveries to North Korea, after some weeks of hesitation, in the face of warnings from the UN World Food Programme that supplies were close to exhaustion.

In the context of their initiatives, the EU and ASEAN will also look for a possible formula to break the stalemate. The ASEAN Regional Forum meeting, to be held in Phnom Penh in June, could provide a venue that involves a multilateral negotiating forum with an opportunity for US and North Korean representatives to hold bilateral talks.

Although the EU is a less visible participant in this and other Asian developments, it has been an active member of the suspended Korean Energy Development Organisation (KEDO), which was set up in the 1990s as an alternative to previous North Korean nuclear activities. KEDO and the US-North Korean Framework Agreement, which had defused a similar nuclear crisis in 1992-94, were suspended following revelations by Washington of North Korean actions in October. A 2001 EU Summit meeting with Kim Jong Il had also helped secure a continued moratorium on DPRK testing of longer-range missiles.

While Washington has repeatedly said that it rejects a military solution to this crisis, it has also steadfastly refused to accept North Korea's call for direct bilateral negotiations, and publicly announced the reinforcement of its military capabilities in the region. As President Bush commented in early March, "If they don't work diplomatically, we will work militarily." US bombers have been dispatched to the Pacific airbase in Guam, and the aircraft carrier, Carl Vinson, will remain in the region even after the recent US-South Korean military exercises. Reports from Washington have pointed out

that should North Korea resume its nuclear programmes, it could produce enough weapons-grade uranium in a few months for several nuclear devices. There have been warnings that North Korea could be tempted to sell such material to "rogue states" or international terrorist organisations, and should it resume testing of its multistage Taepodong missile, it could directly challenge distant US or other targets.

The EU's High Representative on foreign policy matters, Javier Solana, told the EU Summit meeting that while he had been unable to meet the North Korean leader during a visit to the region in February, he had met the South Korean President and President-elect in Seoul, and still hoped to visit Pyongyang. In Seoul Mr. Solana declared that neither he nor the South Korean leaders were in favour of economic and other sanctions against North Korea, as advocated by some in Washington. Both Europeans and South Koreans have argued that such measures could backfire, as have most such recent moves by the US. But they have backed a multilateral approach to resolving the issue, although Pyongyang has insisted that it will negotiate only with the US over the security guarantees it is seeking.

While most analysts believe that a military confrontation is unlikely while the US is engaged with Iraq, they claim that the conditions on the Korean Peninsula are less positive and more dangerous than in the build-up to the Iraq conflict. President Bush's inclusion of North Korea in the "axis of evil," along with Iraq and Iran, and its refusal to deal directly with North Korea's security concerns, as well as North Korean hostility, have left the two protagonists with little room for manoeuvre. Even those in the US, Asia or Europe who favour an engagement with the DPRK, have fewer positive options to offer than in the Iraq situation, in view of North Korea's expulsion of the international nuclear monitors. What is more, North Korea is regarded as even more isolated and potentially desperate than Iraq.

In most of the countries involved there is hesitation, or even opposition, to the tough American position on UN Security Council sanctions and the isolation of the North Korean regime, which Pyongyang has characterised as "an act of war." Some in South Korea and Japan would restrain the flow of concessions, financing and aid to North Korea without tangible reciprocity. The Japanese Government has also stepped up its defence and security preparations, in response to the rising tensions in the Korean Peninsula, while Japan and South Korea have sided in a limited way with the US-led coalition in Iraq, out of a concern that the US could become the only credible defence in the event of a confrontation over Korea.

While some Koreans accept the need for the "big stick" approach to diplomacy favoured by the US, they



quickly add that North Korea's million-man army and conventional firepower make an Iraqi-type pre-emptive strike unthinkable. But a senior Korean diplomat noted that while his country's security concerns are largely limited to the situation on the Korean Peninsula, Washington's concerns are dominated by a more global perception of the threat of the proliferation of nuclear, chemical or biological weapons.

Experts meantime believe that a window of opportunity for negotiations may exist while the US defence presence is largely concentrated in the Gulf. During this period, a determined diplomatic effort will be focused on paving the way for a peaceful resolution of the North Korean crisis, before Pyongyang heads irreversibly towards a nuclear capability, increasing the threat of proliferation. This diplomatic dialogue should largely involve an exploration and possible development of coordinated positions among all the parties, including not only the regional states – South Korea, Japan and China, but also Russia, Europe and the US.

In this search, South Korea's Foreign Minister is headed for Washington. His President, Roh Moo Hyun, who has pledged to continue his predecessor's difficult dialogue with North Korea, has also scheduled a visit to Washington. His message could include an attempt to reorganise the US military presence on the Korean Peninsula, and perhaps even in the region, in the foreseeable future, to project convincing security guarantees for North Korea. After the US-led attack on Iraq, the South Korean President also sought to assure the North that it was not on the US hit list after Baghdad. There was speculation that the US had provided assurances to this effect, going beyond the Administration's official declarations.

North Korea's possible testing of long-range ballistic missiles and its production of fissile material has been viewed by some as further turn of the screw in this tense showdown. But both Asians and European have expressed concern about a possible miscalculation by either side, as a result of which the rhetorical and military confrontation could spiral out of control, as it could have in the recent incident involving a US reconnaissance aircraft and a North Korean fighter in the East Sea. ■

Japan and the War in Iraq

by Dr Axel Berkofsky

When the bombs started falling on Baghdad, Japanese Prime Minister Koizumi stepped in front of the cameras, to express his support for the US-led war against Iraq. "It is regrettable to see the UN Security Council failing to unite in dealing with the Iraqi

crisis," Mr. Koizumi said, adding that the "maintenance of the US-Japan alliance will now be given priority." This translates as: Snubbing the UN is bad, but offending the country's closest ally is even worse.

Things are not that simple for Japan, however, according to the *Yomiuri Shimbun*, Japan's leading daily newspaper. The Prime Minister faces a dilemma, and has "virtually no choice" but to support a US-led strike against Iraq, in the newspaper's view. "It would be completely unreasonable for Japan to refuse to support US-led military action against Iraq, and then ask for US help in shooting down North Korean missiles" it maintains, fearing that the US might decide to leave Japan "defenceless" if it refused to endorse the US-led attack on Iraq.

However, despite Japan's support for a unilateral military strike against Iraq, the Japanese government has decided not to provide logistical support for the US military. The government's refusal to be directly associated with US efforts to get rid of Saddam Hussein by force came somehow as a surprise, since Mr. Koizumi's recent statements suggested that the US could count on its junior alliance partner in the Far East.

During recent months, the Prime Minister did indeed raise hopes in Washington that Japan was on the way to becoming a "fully-fledged" US military ally, ready to provide logistical support for U.S. and British forces in the event of an attack on Iraq. At present Japanese supply vessels are refuelling US and British warships in the Indian Ocean, in support of the US-led military operations in Afghanistan.

Active Japanese support for the war against Iraq is off the table, however, and the Japanese navy, which only a few weeks ago seemed prepared to sail to the Persian Gulf, will not weigh anchor, it now turns out. "We will not enter the Persian Gulf and will not become involved in the operations against Iraq", a high-ranking naval officer pointed out, suggesting that the Japanese military will watch the fighting from the distance.

Japanese Peacekeepers in Iraq?

Whereas strongly supporting the US in a war against Iraq, without UN backing, did not seem to pose any particular difficulties for Japan, deploying Japanese soldiers and peacekeepers in a post-Saddam Iraq, without a UN go-ahead, could turn out to be more difficult. "Since the attack on Iraq was launched without a Security Council resolution, there is no legal basis, under international law, for multinational forces stationed in Iraq," according to a senior official from Japan's Ministry of Foreign Affairs, who added: "The



Japanese military cannot offer assistance just yet.”

The Liberal Democratic Party (LDP) Secretary General, Taku Yamazaki, agreed. He claimed that deploying Japanese military forces in Iraq is “out of question” as long as there is no UN resolution putting the United Nations in charge of rebuilding the country. That, however, was not what Prime Minister Koizumi wanted to hear from his fellow Liberal Democrats. “There might be a phase that does not require a resolution. We can always discuss the issue whether a resolution is required, once we agree to work with the UN,” he suggested, indicating that legal details could be worked out later.

Given that President Bush still appears reluctant to let the UN take over in post-war Iraq, Mr. Koizumi must have been referring to whenever Washington felt like dealing with the UN again. Whether Iraq is run by the Pentagon or the UN, Japanese support, including the deployment of troops, is expected as far as the US is concerned. Howard Baker, the American Ambassador to Japan, met Mr. Koizumi and other senior LDP officials two weeks ago, when he urged them to be prepared to send troops to post-war Iraq.

Ambassador Baker had more homework for Japan: he wants Tokyo to draft and submit a resolution to the UN Security Council dealing with a post-war Iraq. A Japanese resolution, he believes, would face less opposition in countries such as France and Germany than one submitted by the US.

When the fighting is over

After the war, the government announced, Japan will provide Iraqi refugees with medicines, blankets and tents, once the war is over, the Japanese government has announced. It has also signalled its willingness to deploy armed forces to repair roads and bridges, and promised to provide humanitarian aid, worth several hundreds of millions of dollars, to Syria, Turkey and Egypt.

If Prime Minister Koizumi gets Parliament to pass a recent bill authorising the deployment of troops in Iraq, Japanese soldiers could be engaged in providing rearguard support for whatever multinational forces are ultimately stationed in Iraq. They would transport food and medicine and conduct relief measures for refugees. However, getting the “Iraq Reconstruction Bill” through the Japanese Parliament in the near future seems very unlikely.

The Prime Minister, aware that passage of the Bill through both chambers of the Parliament will take time, is of the view that Japan’s peacekeeping law could fill the gap in the meantime. This seems problematic, however, given its numerous constraints, which have significantly limited Japanese participation

in UN peacekeeping missions in the past. What is more, Japan’s peacekeeping law, enacted in 1992, requires a stable cease-fire between the parties to the conflict, and their consent to the deployment of Japanese military forces. The law also prohibits Japanese blue helmets from operating in, or close to, combat zones, which might keep Japanese peacekeepers out of Iraq for some time.

Mr. Koizumi nevertheless announced that the dispatch of Japanese soldiers to a post-Saddam Iraq is legal “as long as Japan’s contribution is non-military in nature.” Apart from providing humanitarian aid to Iraq, the government is also planning to send minesweepers to the Persian Gulf when the fighting is over. In 1991, after the first Gulf War, Japan dispatched a number of minesweepers to the Persian Gulf, after the US complained that Japan’s role in the war was mainly limited to signing checks in far-off Tokyo.

Paying the bill

After the first attempt to disarm Saddam Hussein by force 1991, the US pressed Japan to pay nearly \$13 billion to finance the multinational coalition engaged in liberating Kuwait. No one really thanked Japan on that occasion, and the country was even accused of conducting “chequebook diplomacy.” Japanese cash will be welcome this time round also, of course. The US military campaign could easily cost up to \$100 billion, and political observers in Japan fear that the Bush Administration, sooner rather than later, will urge Japan to co-finance the war, regardless of the country’s economic woes.

Government sources estimate that Japan could pay as much as 20% of the total cost of rebuilding Iraq, and there are plans to use the Overseas Development Assistance (ODA) budget to find the necessary funds. While Mr. Koizumi favours this solution, more cautious government officials have indicated that a “temporary tax” could be on the agenda very soon.

Just \$3 billion of the \$75 billion which President Bush has already requested from Congress for the war against Iraq is allocated to humanitarian aid and the reconstruction of Iraq. Japanese government officials fear, therefore, that Japan will be asked, sooner or later, to provide the missing billions.

On the Home Front

President Koizumi still faces a difficult time at home, explaining to the public why Japan supported a war without a UN mandate. He insists that even without the UN’s blessing, the war against Iraq “falls in line with the UN Charter.” The political opposition claims, however, that a self-declared pacifist Japan became part of a pre-emptive military operation without any legal basis whatsoever.



While the polls note that more than 80% of Japanese are opposed to removing Saddam Hussein without the UN's blessing, for Prime Minister Koizumi public opinion is not entirely relevant when relations with the US are at stake. The telegenic Mr. Koizumi, usually preoccupied with his public approval rating when formulating the country's foreign policy, brushed aside the public opposition to the war, arguing that "there are times when we make mistakes in following public opinion." The public's response was a fall in the Prime Minister's approval rating to below 50%, for the first time since he took office in April 2001.

Mr. Koizumi is indeed in tough spot, in the view of the liberal *Asahi Shimbun*. It claims that his decision to support the war has not only isolated Japan internationally but could soon make him a very "lonely leader." The newspaper believes that "if the war becomes prolonged and support ratings and stock prices drop any further, a no-confidence motion could be brought at the end of the current Diet session." A relatively quick victory, on the other hand, could force the government to introduce higher oil taxes, in order to pay the bill for the US-led war, political observers fear. It seems that supporting a belligerent US could cost Mr. Koizumi dearly, whether in terms of losing his job or taking out his chequebook. ■

Dr Axel Berkofsky is Research Fellow at the European Institute for Asian Studies, Brussels.

China PLA delegation in European study tour

by David Fouquet

An 18-member delegation of the Chinese Peoples Liberation Army (PLA), which is in the midst of an historic conversion, visited France and Brussels in March, in order to look at the current developments and transformation of European foreign and security policy. The delegation took part in briefings and tours in France, in a programme sponsored and organised by the French Ministries of Defence and Foreign Affairs and the Sciences-Politiques Asia Europe Centre in Paris. In Brussels the delegation attended a round table on European security, organised by the European Institute for Asian Studies.

During its month-long study tour the delegation, composed of officers ranging from a colonel and a navy captain to lieutenants, was briefed extensively on developments in national and European defence policy. It visited French military and related industrial facilities near Bourges in Central France, to study French experience and practice in force reduction and conversion operations.

In recent years the Chinese leadership has imposed a substantial reduction in strength of the PLA of some 500,000 men, as well as in its numerous facilities, including the PLA's withdrawal from industrial and commercial activities. This traditional practice is now regarded as incompatible with a market economy and membership of the World Trade Organisation (WTO). But the PLA has also been subjected to major adjustments to partial leadership changes in the move to the "Fourth Generation" of command and a new doctrine, as well as a drive for modernisation, emerging new international geostrategic relationships and, in 2003, a slowdown in the large budgetary increases of previous years.

The PLA delegation's programme of briefings and studies covered both national and European developments and policies. In Paris, for example, it was addressed by the director of the Institute for Studies of the Western European Union (WEU), Nicole Gnessoto, and in Brussels by officials from the European Union (EU) Council of Ministers and the European Commission who handle the EU's Common Foreign and Security Policy (CFSP); a representative of one of the member states on the EU Committee on Security Policy, and a representative of the NATO Alliance.

The delegation was briefed on the current plans for the EU assuming a greater, if still limited, security role and for the adjustment and enlargement of NATO, as well as the difficulties encountered in both those processes. The briefings also covered the debate in both the EU and NATO, and the United Nations, over inspections and possible military operations in Iraq. EU speakers underlined the limited nature of proposed EU operations. They felt that the current process would not suffer the same fate as the Treaty setting up a European Defence Community, which was ultimately rejected and abandoned in 1954.

The PLA delegation was briefed on NATO's new role in counter-terrorism activities, and on EU plans to meet the Headline Goals of fielding a force of 60,000 for peacekeeping and other limited missions that NATO would not assume. As examples of this the delegation was told of the EU taking over from NATO its peacekeeping role in Macedonia, and possibly in Bosnia later, and of the German-Dutch leadership of the international force in Afghanistan.

Questions from PLA members dealt in particular with the prospects for the EU, and especially NATO, being involved in military or security operations in other regions. The concepts of "preemptive" and "preventive" war were also the subject of questions and discussions. A NATO official candidly noted that it probably would be difficult to secure unanimity on broader military operations, unless directly attacked. Questions and discussions also covered the EU-China



dialogue, as it relates to specific strategic and defence issues.

EU-China dialogue includes strategic, conventional arms

Proliferation issues, both global strategic concerns and bilateral conventional ones, have become an important element in the expanding strategic dialogue between the European Union (EU) and China. Their dialogue on nuclear and missile arms control began at their bilateral summit in Brussels in September, 2001, and has reportedly been conducted on a quiet but regular basis since then. While details are sketchy, the discussions appear to have revolved around global concerns and constraints as regards weapons of mass destruction, including possibly the difficult issue of missile defence systems.

The discussions regarding conventional weapons and technology are the more recent manifestation of an issue which emerged in 1989, when the EU imposed an embargo on shipments of military equipment to China, in the aftermath to the Tiananmen Square liberalisation demonstrations and the turmoil that rocked China that year.

Both point to the increased complexity and range of the agenda items between Europe and China. They also underline their discreet search for similarities or compromises on these significant global concerns. These issues also illustrate some of the developments in the EU common foreign and security policy in recent years, as well as its relations with China. While the EU as such is not directly involved in or a party to arms control treaties, it has active programmes on the control of small arms, and has been actively and financially engaged in programmes of destruction of strategic and other weapons in Russia.

The development of this specific EU-China dialogue took place prior to the announcement of the budget plans for defence activities presented to the People's Congress in March, 2003, which foresaw a 10% increase for the year. Although noteworthy, the increase was significantly below the 20% increases registered in 2002 and 2001, which had aroused interest and some concern in the region at the time. The choice in 2003 was said to reflect greater emphasis on spending for social and other civil activities, and budgetary constraints in view of a continuing budget deficit for the year, said to amount to \$38 billion.

But it also was in keeping with previous pronouncements suggesting a desire to reduce the country's large military establishment, including the military's role in largely economic and industrial activities and enterprises. The decision could also be seen as a signal to the international community of moderation. It could thus be regarded as a particularly

restrained reaction to President Bush's decision in May, 2001, to offer Taiwan the biggest arms package in a decade, including weaponry seen as particularly threatening to Beijing, such as eight diesel submarines and four Knox-class frigates. In any case, internationally it was characterised as further evidence of the perception that the Chinese Government would continue to give priority to domestic economic and social development.

Strategic Issues

While such arms control issues have been eclipsed in recent months by initially the global concern and struggle against terrorism, and later the growing prospect and debate over a possible conflict in Iraq, many strategists in Europe and China had expressed comparable concerns in the past about nuclear-biological-chemical (NBC) weapons, and the possible impact of a proposed US ballistic missile defence (BMD).

Both seemed to converge toward a compliance with existing international or even bilateral strategic arms control treaties and conventions, in order to counter the possible spread of nuclear and other weapons of mass-destruction. The issue focused at one point on the new US Government's decision to accelerate plans to develop national or theatre ballistic missile defences, which many in Europe and China regarded as potentially destabilising. Initially, these views tended to regard such US plans as having the ability to degrade other nuclear powers' strategic arsenals, and to be aimed at those of "rogue states" or terrorist groups, which could in turn spur an offsetting increase in Chinese or Russian second-strike capability, in a typical escalatory arms race.

Initially, the main US rationale for such defensive systems were Washington's perceptions of emerging threats from states such as North Korea, Iraq and Iran to acquire capability to launch limited, but lethal, missile strikes against the US. Internationally, this entire process, which included the US intention to withdraw from its Antiballistic Missile (ABM) Treaty with Russia, was regarded as potentially jeopardising the entire structure of multilateral arms control and disarmament agreements, which had been seen as a global stabilising force, or at least a stepping-stone to further progress in arms control.

This was regarded as especially destabilising in the Asia-Pacific region, where it led a number of countries to re-examine their strategic plans and capabilities in the light of the new US defences. While it was ostensibly directed exclusively at the US-North Korea balance and relationship, it was also regarded as having complicating consequences for China and its own strategic and political relations with the US, Taiwan and Japan. If China deemed its own defensive nuclear capability eroded by a US system said to be aimed



against a potential North Korean missile threat, would it respond by developing additional nuclear capability, and what would be the reaction in Taiwan or Japan? Both the latter had also expressed interest in acquiring some form of BMD, including in collaboration with the US. Japan has also launched the acquisition of refueling capability for some of its aircraft, in order to provide them with a range that could be regarded as a potential threat to other countries in the region.

In 2002 some reports suggested that China was in the process of increasing its arsenal of some 20 strategic long-range nuclear missiles to as many as 60 by the end of the decade, including some solid-fuel and mobile missiles.

When the EU and China incorporated such issues into their bilateral summit and political dialogue at their meeting in Brussels in September 2001, these concerns were priority issues they sought to address in the future. At the time, some attention was being focused on European and other diplomatic initiatives aimed at strengthening existing multilateral strategic arms control and disarmament regimes, and perhaps developing new instruments. One such initiative had been launched by German and French leaders a few months earlier. A related discussion eventually led to an outline accord in 2002 on a Draft Code of Conduct Against Ballistic Missile Proliferation, which was seen as strengthening the looser informal and voluntary Missile Technology Control Regime which 33 countries adhere to.

In August, 2002, China also announced the adoption of ballistic missile technology export restrictions aimed to mirror in the international MTCR, which China is not a party to. At that time, the Government said it would soon issue lists of missile-related and dual-use technologies that would require export licenses. This was seen as helping to implement a pledge by China in 2000 that it would not help third countries seeking to develop nuclear missile capability.

In 2002 the international reaction to the withdrawal of the US from the ABM treaty, and its continued testing of BMD technology, was muted and perhaps overshadowed by the more immediate preoccupations with terrorism and the impending war in the Middle East.

Conventional Arms Issues

Some American and European sources and studies have noted a growing activity on the part of China in the past in strategic development and supplies to other countries, including some, such as Pakistan, North Korea and possibly others, which have aroused interest or suspicion. A similar pattern has also been reported by bodies such as the Stockholm International Peace Research Institute (SIPRI), suggesting that China has

become a major customer and supplier of conventional military equipment. But perhaps the most controversial element of this dialogue is said to be the recent Chinese requests for the lifting of the 14-year old EU embargo on exports of military equipment. The pressure for its termination has been reported as coming not only from China but also from some European government and industry sources.

The issue was raised publicly in October, 2002, by Chinese Prime Minister Zhu Rongji during a visit to France after the Asia-Europe Summit Meeting (ASEM) in Copenhagen, and also diplomatically in closed EU-China talks, according to some reports. But some European sources, such as the former French Defence Minister, Charles Millon, in the 1990s, have also suggested at least a review of the boycott, while some countries have begun over the years to apply a looser definition of the restrictions, in order to deliver spare parts or non-offensive defence equipment to Beijing, naturally regarded as a potentially major purchaser.

While there have been few cases of reported breaches of the embargo in Europe, major American companies such as Boeing and Hughes were under judicial examination on charges of having illegally delivered satellite technology to China, and were eventually fined in 2003. The US has also denied American firms permission to export satellites to China for launching.

Prominent European firms, such as Rolls-Royce, have acknowledged in recent years that they have continued to deliver military-related equipment to China. The British firm said that it agreed to supply some 90 of its Spey Mk202 engines to China, to power the new domestic JH7A fighter aircraft which Beijing expects to deploy in 2004. The firm has explained that the engine is based largely on technology from the 1960s and 1970s, and that it had been covered by supply contracts dating back to that period. Rolls-Royce has been delivering engines to China since the 1960s, and developed a number of joint ventures in the civilian sector. In the 1970s other Rolls-Royce engines reportedly were tested on a variant of the country's H-6 nuclear bomber.

British, French, German and other firms have also been reported to have exported radar, electronics, satellite and even defensive missile technology and equipment to China in recent years since the embargo implementation. Such firms see the Chinese market as a promising one for marketing and industrial collaboration, and have regarded the embargo as complicating and restricting this potential. ■



Interview: PLA Capt. Yang Yi

Relations between the Chinese Communist Party (CCP), the State and the People's Liberation Army (PLA) are widely debated in China. Is the PLA a political army or a professional one? Today's CCP leaders may have no military background, but senior PLA officials take part in the decision making process, through both formal and informal channels and the Central Military Commission (CMC) still controls the PLA. The issue is often associated with the question, "Does the Party control the gun?"

These are among the issues Naval Captain Yang Yi discussed, on 11 March, during the EIAS Round Table on European Security. Capt. Yang Yi is Director of the Institute of Strategic Studies of the National Defence University, Beijing, and a former naval attaché in China's diplomatic mission to Washington. For Capt. Yang Yi, the PLA serves the State but is led by the Party, in accordance with China's Constitution. In the current era of pacification, China is concentrating its efforts on economic development, rather than on defending itself from external threats. Consequently, the army's role has changed and today the PLA is going through a continuous process of streamlining and greater professionalism.

The separation of the CCP and the PLA could result in a more autonomous and professional army, linked to the State rather than the Party. As matters stand, the nature of the relationship between the Party and the PLA remains a mystery; that could only be clarified if a serious internal challenge to the authority of the CCP emerged. Thus, if the current social unrest were to lead to massive protests, the army could be called to intervene, as it was in June 1989. In this case, I suggested to Capt. Yang Yi that the PLA would have to choose between standing side-by-side with the protesters or obeying the orders from the CCP.

Capt. Yang Yi assumed that in the event of major social unrest, the CCP would not order the PLA to attack the protesters. He thought the 1989 incident was due to the Party's lack of experience in the practice of democracy. Today's CCP is more confident about reform and is committed to the building of the People's Democracy, in accordance with constitutional law.

Following Deng Xiaoping's example, Jiang Zemin left the presidency to the newly appointed Hu Jintao but retained his position as Chairman of the CMC. Jiang has made sure that his theory of the Three Represents is welcomed by the upper echelons of the PLA. He has announced these key themes for the future development of the PLA: politicisation and loyalty to the Party, professionalism, modernisation, doctrine, research and development and the protection of state sovereignty.

For Capt. Yang Yi this is a normal feature of the transition process. Deng was pushed to retain his post as Chairman of the CMC for 2 reasons. The 1989 incident had created momentary instability within both the Party and the State. At that time Deng considered Jiang Zemin to be too inexperienced to take over the chairmanship. This had also to do with the prestige and influence held by the Party's senior leader: Jiang today has undisputed authority over his Party colleagues.

Corruption in the PLA reached its apex in the late 1980s and early 1990s. One of the most famous cases involved oil smuggling by the head of the Yuanhua Group, Xiamen city, with the assistance of local customs and military officials. By July 2002, 14 officials had been sentenced to death for their involvement in the smuggling operations. In 1996, during an enlarged meeting of the CMC, Jiang stressed the "three virtues" (patriotism, socialism and collectivism), in contrast to the "three evils" (money worship, hedonism and individualism), and explicitly condemned corruption and nepotism.

In 1998, Jiang called for the conversion of the military's business activities to civilian status. Jiang's order was not designed to remove the PLA entirely from the economy: trade was banned, while production was to continue. Some 8,000 to 10,000 smaller enterprises, mainly subsistence-oriented, were not involved in the reform, together with sectors such as civil aviation, the railways and communications. Capt. Yang Yi confirmed that the 1998 reforms had been fully implemented. The PLA's commercial sector was not an issue, as the army is a professional army and is not engaged in business.

Today, the current streamlining and moves to greater professionalism of the PLA may play an important role in reducing corruption. The central authorities' serious attempts to tackle corruption have brought about bureaucratic and political conflicts creating resentment within the military. However, the outcome of the 1998 reforms is still under discussion and a certain level of corruption in the PLA is expected to persist.

Both the CCP and PLA are faced with a need for reform that would imply substantial political changes for the entire country. While the PLA was consistent in the 1960s with the Maoist principles of the Cultural Revolution, a modern professional army would have to be consistent with a democratic multi-party state. Political reform in the PRC will perhaps shed light on the future role of the present Chinese leadership and of the PLA. For Captain Yang Yi state, party and army are undergoing an irreversible process of opening up. Will the result be the creation of a "People's democracy," with Chinese characteristics? ■

Roberta Zavoretti

The Impact on Asia of the War in Iraq

The European Institute for Asian Studies (EIAS) organised a Round Table on the economic and political impact of the war on countries in Asia. It was held in the European Parliament, with the support of John Cushnahan, MEP. Two of the talks which served to launch the discussions are printed below, together with a summary of some of the main points made by participants during these discussions.

The Economic Impact of the Iraq war on Japan, China and India

by Dr Sushanta Mallick

The war in Iraq would impact the key players in Asia as much as it would any other major economy. Asian economies account for about 25% of US\$31.5 trillion world gross domestic product (GDP), and clearly are one of the major players in the global market place. Prior to the war, the uncertainty centred on when the war was going to start, and it was factored into the markets, including the oil market. Now the market sentiment is centred on when the war is going to end. This kind of uncertainty continues to discourage consumers and investors from undertaking their planned expenditure at this time.

What are the channels of transmission of this kind of shock to the economy? There are essentially two kinds of impacts. The direct, or first order, impacts of this shock will be the same as those witnessed in the last Gulf war, when oil prices increased sharply – a matter of concern to all the oil-importing countries – and equity prices fell sharply. Both business- and consumer-confidence were hit as a result of the uncertainty, and that in turn depressed capital markets and slowed down economic growth. Certain sectors also suffered particularly badly, including tourism and the aviation industry.

The combinations of higher oil prices, weaker confidence and lower equity prices therefore contributed to slower growth, in the aftermath of the last Gulf War. We have already seen a similar kind of impact so far in this Gulf war: the oil price has jumped to its highest level since the last Gulf war. New records could be set in the course of this war, if oil supplies are substantially reduced in the medium or long term. Besides, there is one direct positive impact that could come from higher defence spending, offsetting a part of the negative knock-on effects and stimulating

economic growth. But that cannot be significant relative to the negative effects.

The second order impact would depend on the outcome of the war, and whether the war achieves its objectives of getting rid of weapons of mass destruction and bringing about regime change in Iraq. Any war obviously has negative impacts. If the war in Iraq escalates into a prolonged, large-scale conflict, it carries the risk of tipping the global economy into recession. For example, prior to the last Gulf war, the US and other economies were already weak, but the war pushed them into recession. This time also, since the global economy is already weak, long-term uncertainty as a consequence of a prolonged conflict could create a similar recession.

How should policy makers respond to this kind of negative shock? In terms of monetary policy, there is little room for additional easing in the US, as the Fed funds rate is already at a record low level. Japan, finding itself in a deflation trap, has little scope for additional monetary and fiscal stimulus to offset any negative economic impact of the war. However, in the eurozone, given the appreciation of the single currency, and in the UK, there is some room for further relaxation of policy, to counteract any negative shock coming out of the war.

War is usually viewed as a temporary phenomenon, but the efforts to deal with terrorism have been more long-term in nature since the events of September 11 erupted. The long-term nature of this war injects a great deal of uncertainty into economic behaviour, indicating a more faltering global economy. Even before September 11 the global economy had been slowing down since the technology bubble burst in March 2000. It is already in recession, although not in a technical sense, with highly volatile consumer and business confidence.

Higher oil prices will certainly add to the problem, particularly in Japan, China and India, since all the three countries are oil importing countries, mainly dependent on the Middle East. China is the world's third largest consumer of crude oil, after the US and Japan. It imports one-third of its oil requirements, 60 percent of it from the Middle East. The long-term impact on oil prices would depend on how badly the oil infrastructure is damaged in an extended war, and to what extent oil supplies are squeezed.

This uncertainty in the Middle East will make oil prices volatile in the short term, but a long-term rise in oil prices is more likely to cut global economic growth. The long-term strategy therefore should be to diversify the sources of supply, rather than to rely heavily on the Middle East. China, for example, is already looking to diversify, with Russia among its potential sources of supply. Diversification is always a good strategy,



whether it is with regard to export markets, sources of foreign investment or of foreign exchange earnings, such as tourism. Over-dependence on any one source is risky.

China and India are more likely to outperform all of their neighbours in terms of growth, despite this negative shock. While they are very different economies, a common characteristic is their strong domestic demand. Although China has been relying recently on an export-led development strategy, domestic demand remains quite robust and is supporting growth.

A major source of foreign exchange for India is represented by non-resident deposits and private transfers by Indian residents working abroad, particularly in the Middle East. If the war spreads beyond Iraq, it is possible that inflows from this source could dry up, as happened during the last Gulf war. This worsened India's balance of payments problem and gave rise to a crisis in July 1991, although severe fiscal and external imbalances were the main reasons for it. At that time India just had under US\$4 billion in foreign exchange reserves, as against over US\$74 billion this time. India is therefore unlikely to face such a crisis this time.

Outside investor confidence is crucial for capital flows to both China and India, given economic arbitrage. Thus although in general China could be a risky market, the reality is that foreign direct investments have increased over 50% year-on-year in the first two months of this year, at a time when there was a huge risk of war. This suggests that China is viewed as a safe haven at a time of uncertainty.

In terms of exchange rate effects, China actually benefits from this war uncertainty in the sense that Chinese Yuan being pegged to the US dollar becomes more competitive in line with the falling dollar, while Japan is being hit hard by the dollar weakness that makes the Yen less competitive.

To sum up, one can envisage three possible scenarios. **Pessimistic** (the war goes badly for the West): The cost of the war turns out to be much greater than anticipated, and the West does not find weapons of mass destruction. This could result in continuing global instability, with regional consequences, and the recession could deepen. The longer the war lasts, the more destructive it becomes. In addition, Saddam Hussein's best chance of survival is to escalate the conflict beyond Iraq, possibly by attacking Israel or by portraying the war as an attack on Islam, rather than on his regime.

Intermediate: the war goes well (victory, but at significant cost): The disruption of oil supplies can be managed, while the global economy gets a boost.

Money in frozen accounts and Iraq's annual oil revenues of US\$20 billion can be used to rebuild the country.

Optimistic: The war goes very well (victory, with a contained war): This scenario suggests that the West finds weapons of mass destruction, reinforcing the rationale for the war. There is a perception that the next move could be against Iran or North Korea. If something like that were to happen, the long-term uncertainty would continue and that in turn would keep the markets range-bound. The settlement of the Iraq crisis, by removing 'geopolitical uncertainties', could give the global economy time to recover.

The idea that poverty breeds terrorism has come up in academic and policy debates. In fact, there is no simple and straightforward relationship between the two. Such statements do contain an element of truth, however. There seems to be a trade-off between global poverty and international security. Poverty may not cause terrorism, but terrorists may manipulate poverty and income inequality between rich and poor nations to their advantage. Any viable strategy to prevent terrorism must therefore address the core issues of economic development in the Third World.

Many G-8 countries, including the US have pledged to increase their development aid to poor nations, attempting to curb poverty. But foreign aid is no answer to raising living standards in the poorest nations, although it can be an important instrument for reducing poverty marginally, if it is used productively. But a large part of the foreign aid received by low and middle income countries is used to meeting the government's current expenditure, rather than being spent on capital expenditure to create the productive employment that can provide a sustainable solution. ■

Dr Mallick is with the International Economics Programme, Royal Institute of International Affairs, London.

The Iraq war: what economic consequences for Asia?

by Dr Willem van der Geest

The Iraq war seemed to have passed the phase of major combat as the *EurAsia Bulletin* went to press. After a long-drawn battle over Basra, with major humanitarian costs, the fall of Baghdad came more swiftly and with fewer coalition casualties than even their own spokesmen predicted. Equally importantly, Kurdish



and US forces occupied the northern town of Kirkuk, the crown of Iraq's oilfields. Kurdish forces, joined by US troops, proceeded without delay to capture Mosul. This was despite concerns from the Turkish government about the prominent role of the Kurds just south of its border. What remained was the final battle for Tikrit, the home-town of Saddam Hussein. Troops loyal to him were expected to offer fierce resistance, but only limited fighting took place, and the city was swiftly being brought under the control of the coalition.

Yet, not all had been smooth sailing for the Anglo-American coalition. First and foremost, Saddam Hussein vanished from Baghdad overnight without a trace. Equally puzzling was the disappearance of nearly the entire senior Iraqi leadership, including Tariq Aziz, the Foreign Minister. Even the Minister for Information, who had been holding press conferences from his shell-shocked Ministry just hours earlier, was nowhere to be found. Out of 55 people wanted by the coalition, only the senior science advisor to President Saddam surrendered himself, while one of Saddam's half-brothers was captured. The extent of looting, civil violence and disruption of even the most basic of services across all the major towns of Iraq caught the coalition off-guard. Hospitals, historical museums, municipal buildings and Baath party centres became the objects of bold and vicious plunder. Patients were found wandering the streets alone, while hospitals found themselves without doctors, nurses, medicine or water. Furniture, kitchen equipment and air-conditioners were hurriedly carried away from public buildings, under the indifferent eyes of inactive law-enforcing agencies and non-interfering coalition forces.

Two Scenarios for the Iraq War

Although it is still too early to draw a definitive picture, some preliminary insights into the global political and economic fall-out of the Iraq war may be developed, with a focus on Asia. Two broad scenarios need to be distinguished. The first assumes that the 'short and effective' military campaign will be followed by a relatively smooth political transition to a stable post-Hussein government. The second scenario assumes, much less optimistically, that combat, perhaps of a major kind, will not be over for several months to come. It also assumes that the transition to a post-Hussein government will be problematic throughout 2003.

This scenario also recognises the possibility of regional instability, with military operations perhaps taking place on Iraq's northern border with Turkey and its western border with Syria. Finally, it assumes that restarting regular supplies from the Kirkuk and Rumaila oil-fields will not be without its problems, due to technical reasons and sabotage. Because it is difficult to determine the degree of probability for each of these scenarios, we will consider both. It is

evident that if the combat phase of the Iraq war is completed shortly, the first scenario is the more likely one.

The first scenario – a 'short and effective war followed by a smooth transition' (within 3 months or less) – would be characterised by:

- A rapid restoration of civil order after the fall of Baghdad and the other major towns, e.g. within 4 to 6 weeks of the start of the campaign.
- Civil and military control by the coalition over northern Iraq, including oil-rich Kirkuk, Kurdish Mosul and Saddam's home base of Tikrit.
- The final demise of Saddam and his Cabinet as well as the Republican Guard.
- Installation of a 'Transitional Government' with US and/or UN backing and with support from the EU and other countries.
- A limited number of casualties from coalition action.
- Effective management of humanitarian crisis and quick relief.
- A start on Recovery, Rehabilitation, Reconstruction (RRR), going beyond humanitarian relief.
- Oil output is back to pre-war levels at least, is perhaps even up to 2.5 million barrels per day, i.e. above 2001 and 2002 production levels.

The second scenario – of 'continued combat and uncertainty, and a problematic transition' during the next 3 to 6 months or so, would be characterised by:

- Continued combat in the north and/or west, possibly involving Kurdish separatists and/or militia backed by other regional powers, e.g. Syria or Iran.
- A resurfacing of Saddam Hussein.
- A failure of General (retired) Jay Garner's transitional Iraqi government to gain control and legitimacy.
- Recurrent humanitarian crises.
- Very limited Recovery, Rehabilitation and Reconstruction (RRR).
- Further political isolation of the US/UK coalition.
- Oil output fails to restart, due to technical problems and/or sabotage, and remains at a low level of 0,5 million barrels per day, near to the 1995 level.

Economic Consequences for Asia

The five channels through which the possible economic consequences of the Iraq war on Asia can be transmitted are: trade flows, investment flows, people flows, financial flows and, last but not least, aid flows.

Energy Markets. On the trade side, one of the main determinants will be the changing level of oil prices. In the run-up to the Iraq war, oil prices captured a war premium of some \$5 to \$10 per barrel during several months. It seems to have evaporated with the cessation of combat, but problems in Iraqi oil production, or a resurgence or intensification of military operations in the north or west of Iraq, might bring back uncertainty and higher oil prices. How other OPEC producers will respond is particularly important. Will Saudi Arabia cut its quota below its present level of 7.9 million barrels per day?

Virtually all Asian countries are heavily dependent on oil imports, and Asia's share in world oil demand is 25 per cent. It is expected to continue to grow steadily by at least 3 per cent a year, to reach 28 per cent of world demand by 2020. Dependence on supplies from the Gulf OPEC producers is particularly high in the Asia/Pacific region.

South Asia depends on oil for one-third of its commercial energy consumption. India is oil-dependent to the extent of 30 per cent, but for Sri Lanka or the Maldives the corresponding figures are 76 per cent and 100 per cent respectively. Moreover, South Asia's energy consumption is high per dollar of GDP, which indicates an inefficient use of energy. A shift away from oil imports would require massive investment, especially in hydro-electricity, as well as effective regional co-operation.

Goods and Services. As for non-oil goods and services, the lion's share of Asian exports are destined for the EU and US markets. Any further slowing down of these major locomotive economies will lead to an oversupply of goods and falling prices for Asian exports. The recent issue of "Economic Outlook" from the IMF in no way eliminates concerns about slower growth in either of these markets. It is next-to-impossible to separate the effects of the geopolitical situation from those due to the economic cycle. Global corporate earnings have fallen sharply since the IT-bubble burst in the late 1990s. Whatever the reason for it, there can be little doubt that any further slowdown of the EU and US economies will lead to a sharp fall in export prices, sharply limiting the growth of Asian export earnings.

Investment and Finance. Uncertainty tends to affect investment decisions and financial markets in a similar fashion. Faced with greater risks and uncertainty, investors will only go ahead if the expected earnings are very high – otherwise their most likely course of action is to wait and see. Decisions by EU and US companies to invest in Asia will be on hold until the dust has settled. Bankers, too, will seek greater security in the face of adversity. Hence, the funds available for investment in Asia's emerging markets is likely to be subdued.

People flows. During the first Gulf War a mass exodus of workers from the Gulf took place, but the pattern appears to have been different, this time round. Many expatriate Asian workers, and those from the Philippines and South Asia in particular, banked on a short and successful war and stayed put. Migration to the region halted, nevertheless. Indian Airlines, for example, reported that its flights to the Gulf region were much below capacity. If the first scenario prevails, the impact of the war on remittances as well as on earnings from tourism may remain limited. However, any threat of a drift towards the second scenario will lead to reduced remittance flows for South Asian countries, affecting their current accounts negatively. It has now transpired that the impact of the dreaded SARS on people flows to and from Asia is much greater than that directly linked to the Iraq war. Several major Asian airlines, including Cathay Pacific, were forced to cancel numerous flights. This will inevitably lead to sharply reduced earnings across the service sector, in particular in tourism, hotels and business services.

Aid diversion. Last but not least, some representatives of Asian countries have expressed concern about the threat of aid being diverted towards Iraq's post war reconstruction, which is expected to cost tens of billions of dollars. This could affect Central and/or South Asian countries very significantly. The international community pledged substantial amounts for RRR in Afghanistan, to support the transition to a legitimate and elected government by 2004. Independent assessments indicate that present aid levels are already inadequate, despite quick disbursement and implementation during 2002.

The continued dominance of war lords in major areas outside Kabul, a return to poppy cultivation and the incapacity of Hamid Karzai's transitional government to address the country's enormous social and economic needs, because of institutional weaknesses, point to the urgency of continued development assistance. Other Asian less developed countries (LLDCs), such as Bangladesh, Nepal, Cambodia, East Timor, and Laos, may also face stricter conditionality when seeking development finance, against a background of donor fatigue, the low impact of aid projects/programmes and transparency concerns. The scale of aid diversion will also be critically affected by the extent to which past revenues from the Oil-for-Food programme are available for Iraq's reconstruction, and revenues from fresh oil sales become available for RRR. ■

Dr Willem van der Geest is Director, EIAS, Brussels. The full text of this article, including a chart on the "Iraq war as an economic shock for Asia", will shortly be available on www.eias.org. The chart describes the five channels in greater detail.



General Discussion

The discussion that followed the Round Table presentations focussed on the nature and direction of post-war Iraq, viewed from an economic and political perspective, and the religious aspects of a dialogue between civilisations.

The plight of the Shia majority in a Sunni-dominated Iraq was raised in the context of a post-Saddam Iraq. One of the risks of the capitulation of Saddam Hussein's regime could be an explosion of Shia violence against Sunni rulers or civil servants, following years of domination and repression. One of the participants highlighted the strong probability of Shias in countries as diverse as Iran, Iraq, Lebanon and even Saudi Arabia forming a large Islamic alliance. Tensions within the Shia population itself, between its more radical elements, on the one hand, and its progressive elements on the other, represented yet another destabilising factor in the post-Saddam situation.

Ms Eva Rakel, a researcher at Humbolt University, Berlin, noted that to date there did not appear to be any major upheaval among the Shias. They had neither joined the US coalition in great numbers nor asked Iran for assistance.

Many participants spoke of the challenge to moderate Islam that the invasion of Iraq, or the fall of the Saddam government, represented. The forces of moderation in the region would be weakened in the long term, and radical forces strengthened. The latter were more likely to reject a dialogue with the West, a move which would influence attitudes in moderate Islamic countries.

The pressure on countries to join the US-led coalition earned it the nickname of the coalition of the "brow beaten" in some quarters. Willem van der Geest, Director, EIAS, suggested that a better name would be "the coalition of the persuaded." On an economic level, the politicisation of market access could pose a very serious threat to the multilateral system of the World Trade Organisation (WTO).

The subject of the costs associated with the reconstruction of Iraq was also discussed. The Americans held that the sale of Iraqi oil would help meet these costs. However, it was suggested this could lead to the problem of aid being diverted away from Iraq, when it needed it most.

A slowdown or disruption of the economy would affect ordinary workers in Iraq and Saudi Arabia. Many South and South-East Asians work in the Middle East and send remittances home. One participant felt that their situation should be taken into account, when

reparations were being decided on. After the first Gulf war some developing countries proposed that a Trust Fund be established, but the scheme was based, unfortunately, on voluntary contributions. Something similar but more stable should be set up after this war, a participant suggested.

Referring to political relations in Asia, a participant noted that one outcome of the war has been the usurping by China of Japan's traditional role as "spokesman" for Asia. This shift is being reinforced by South Korea's acquiescence towards Beijing, as Seoul seeks China's help in defusing tension on the Korean peninsula. David Fouquet, EIAS Secretary General, agreed, noting that shifting political allegiances in the Asia-Pacific region were allowing China to carve out a role for itself.

Another participant wondered whether the United States was not using the crisis on the Korean peninsula to garner South Korean and Japanese support, by telling Seoul and Tokyo that without adequate support for the coalition in Iraq, it perhaps could not assure their security.

The effect on Pakistan of the war in Iraq was judged to be both economic and political. Pakistan straddles a political faultline, where Arab Islam ends and Asian Islam begins. The fall of the regime of Saddam Hussein would represent a watershed in the life of Islamic countries. Most have authoritarian governments, with civilians suffering restrictions on their behaviour and lifestyle.

Concluding the meeting, John Cushnahan, a member of the European Parliament, held that the war in Iraq was both premature and unjustified. Military intervention should be considered only when all other avenues have been exhausted. The war in Iraq had clearly displayed the cracks in the European Union's common foreign and security policy (CFSP). If the EU is to make use of its influence, it will have to organise itself appropriately. The EU exists in a unipolar world with a dominant United States as hegemon. The EU should clearly reject anti-American attitudes, while recognising that there must always be room for criticism in a close relationship.

The European Union should examine the context within which terrorism occurs, Mr. Cushnahan said. The EU has numerous tools at its disposal in its external relations, including Trade and Co-operation Agreements, development aid and sanctions. He felt that Europe will come in for criticism, as being colonialist or imperialist. Asian countries are too ready to say that the EU does not understand "Asian values". However, the concept of democracy is not solely European, but universal. ■

John Quigley

The EU's GSP after 2004

by Ralph Kamphöner

When launching the Doha Development Agenda in November, 2001, trade ministers from all the countries belonging to the World Trade Organisation (WTO) acknowledged that the liberalisation of international trade offers the potential for more rapid growth and the alleviation of poverty, which is the key to development in the less well-to-do regions of the world.

Improving market access for developing countries is an important contribution that rich countries can make to fight global poverty. It would be hypocritical, against this background, to encourage poor countries to open their markets, while the European Union (EU) imposes protectionist measures to defend its domestic interests. The EU must take a leading role in dismantling the artificial protection accorded its own manufacturers. At the same time, it must provide true incentives for expanding trade with the developing world.

World trade in products of export interest to developing countries is still heavily distorted. Market access barriers in industrial countries tend to be directed against labour-intensive manufactured products and agricultural goods. It is essential, therefore, to grant autonomous and non-reciprocal trade preferences to all developing countries, under the generalised system of preferences (GSP), in order to facilitate market access for products from developing countries.

The new GSP Cycle

Given that the new GSP will run from 2005 to 2014, there is an obvious need for a far-sighted approach. Questions of whether and how to reform the system, as regards such issues as social and environmental clauses, graduation provisions, etc., are already being asked. These and other topics must be discussed after a thorough assessment of the current GSP. In particular, its results must be analysed, to see whether and how far it has provided stakeholders a genuine incentive to increase trade.

The stakeholders are the exporting countries and EU importers. If the European Commission wants to adjust the GSP to take into account the development objectives pursued by the EU, it must do so in the light of the practical needs of both exporters and importers.

In the past, the gains which the beneficiaries have derived from the GSP have all too often been limited, because of the complex graduation mechanisms that make products ineligible for GSP treatment, the

smaller preference margins for "sensitive" products and the puzzling rules of origin.

True incentives

Past experience dictates the major characteristics of the new GSP:

1. Simplicity. The system must be easy to understand and easy to implement, for both developing countries and importers. Complex, bureaucratic provisions are contrary to the aim of encouraging the exports of developing countries. A system that is simple to operate would also eliminate the need for costly technical assistance and capacity building programmes in developing countries.

2. Transparency, predictability and legal certainty must be ensured. This has not always been the case so far, as regards the annual adjustment of the graduation provisions, for example.

3. The new system must promote economic development. In the past, the EU has made too many concessions to its own manufacturing industry. This has worsened the terms of trade of many developing countries. It also runs counter to the EU Lisbon Strategy, which was adopted in order to make Europe the most competitive and dynamic knowledge-based economy in the world by 2010.

Elements of the new GSP

To implement these objectives, the European Commission would do well to consider a number of aspects concerning products, countries, special incentive arrangements, graduation, nuisance duties, preferential rules of origin and stakeholder consultation.

It is enough to differentiate between just two types of countries and two product categories, sensitive and non-sensitive. Product coverage under the present GSP system, although extensive, does not amount to full product coverage. What is more, there is still considerable scope for eliminating all specific duties in the agricultural and processed sector, as, for example, in the entry-price system and all tariff quotas. In addition, differences in product coverage between the ACP Cotonou Agreement and the GSP should be eliminated. Finally, sectoral or product-specific exclusions should be abandoned, because they reduce the practicability and predictability of the system.

Special incentive arrangements for the protection of labour rights and the environment should not be included. Although nobody seriously denies the need for addressing social and environmental concerns,



trade policy instruments in general, and the GSP in particular, are not suited for addressing these issues.

Special incentive arrangements under the GSP have not proved to be enough of an incentive to encourage countries to do more to meet these standards. On the contrary, they make the application of preferential schemes more difficult and result in considerable legal uncertainty.

It is often impossible for importers, particularly small and medium-sized enterprises, to trace the origin of a commodity, the circumstances under which it was produced and the chemical substances it contains. Hence, an inclusion of special incentive arrangements would unnecessarily expose these companies to more bureaucracy, higher costs and the risk of being held liable for possible – not to say unavoidable – mistakes.

On the side of the exporters, India recently filed a WTO Dispute Settlement complaint against the EU. It pointed out that special incentive arrangements are accorded only to countries determined by the EU itself. Under these conditions, India argued, the tariff preferences granted by the EU are inconsistent with GATT 1994 and do not meet the requirements of the Enabling Clause. Thailand had lodged a similar challenge in 2001. Both these looming disputes add to the legal uncertainty surrounding special incentive arrangements.

The graduation clause contained in the present GSP system has proved to be impracticable. This is mainly due to the complex differentiation between specific countries and between sectors. It clearly is incompatible with the intention to make the system easier to handle by importers and exporters.

A graduation clause, by its nature, creates the need for continuous adjustment. This might be feasible in theory, but in view of the notoriously controversial discussions on graduation in 2003, it seems highly desirable to drop all such provisions from future GSP schemes. If the graduation clause cannot be simplified drastically, its complete deletion is in the best interests of all stakeholders.

In view of the burdensome bureaucratic procedures of the GSP, the question of nuisance duties needs to be specially addressed. Trading companies have suggested at various times in the past that duties be suspended totally, whenever preferential treatment results in *ad valorem* duties of 3% or less, or in specific duties of €5 or less. This recommendation should finally be implemented in the new GSP cycle.

Importers need time to develop and adjust their planning. When plans for graduation in 2003 became public in the autumn of 2002, most of the contracts for the coming year had already been concluded. The

surprise withdrawal of tariff preferences inevitably results in additional costs, which smaller companies, those specialising in narrow product ranges in particular, can find extremely hard to cope with. Changes in preferential treatment of a country or product must be made public, therefore, at least one year before they come into force.

An “Early Warning System” for importers could serve as a supplementary tool to provide better predictability and legal certainty. It could be operated, for example, on the website of the European Commission, in the form of a “one-stop shop” to alert traders to changes in preferential tariffs, whether proposed or adopted.

Preferential rules of origin must be urgently simplified, in parallel with the launch of the new GSP cycle. Those that currently apply are too complicated and ambiguous, and thus act as a constraint on the very trade they are supposed to encourage.

Determining the preferential origin of a product is a complex procedure at present. It requires an in-depth knowledge of a very large number of legal texts, concerning especially textiles and clothing, fishery products, processed agricultural products and foodstuffs. The documentary evidence needed to prove that a product qualifies for preferential treatment is often so costly that it exceeds by far the value of preferential margins. More user-friendly rules should therefore characterise the new GSP. They exist already in the form of the EU’s non-preferential rules of origin. The latter could easily be applied also to products covered by the GSP.

Such a major simplification is highly desirable; whether it can realistically be achieved is another matter. It would already be helpful, however, if global cumulation – cumulation covering all GSP beneficiary countries – were to be introduced. This would not only simplify the provisions for cumulation, but also encourage an efficient division of labour between developing countries, thus making them more competitive overall.

Finally, the launch of the new GSP cycle requires adequate stakeholder consultation in good time. It was very unfortunate, from a legislative point of view, that the final draft of the current GSP scheme, covering the period 2002-2004, was transmitted to the EU Council of Ministers without any prior exchange of views with the interested parties.

The European Commission recently launched a wide public debate on the principles of good governance and better law making. The new GSP cycle would be a good opportunity for it to show that this is not an exercise in window dressing, but that the EU will listen to the proposals and legitimate concerns of the



beneficiary countries and traders. This will result in a new GSP of high quality and effectiveness. ■

Ralph Kamphöner is an International Trade Adviser with Eurocommerce, the retail, wholesale and international trade representation to the EU.

Bangladesh in the GSP

Some 30 years after the European Community introduced its first generalised system of preferences (GSP) scheme, aimed at promoting imports from developing countries, the European Commission is looking at some of the key provisions of the scheme to be introduced in 2005, for a 10-year period. This article looks at the experience of Bangladesh, which ranked 7th among the GSP beneficiaries in 2001, the latest year for which detailed statistics are available.

Bangladesh's total exports to the 15-nation European Union (EU) came to €3.3 billion, 98% of which were entitled to preferential entry under the GSP scheme. In point of fact exports worth just €1.6 billion actually benefited from the scheme in 2001. The utilisation rate, in other words, was only 50%, well below the utilisation rates of India (75%) and Pakistan (79%).

As one of the 48 least developed countries, Bangladesh is entitled to duty- and quota-free access under the EU's "Everything But Arms," or EBA, scheme, which came into force on 5 March 2001. When EU governments approved the scheme on 26 February 2001, the Trade Commissioner, Pascal Lamy, told a press conference: "We have delivered on our fine words. This sends a signal to the rest of the world that we are serious about getting the most disadvantaged to share in the fruits of trade liberalisation."

Just under half (47%) of Bangladesh's exports are to the EU. However ready-to-wear garments account for almost three-quarters of the country's income from these exports. Some 60% of these garments, such as shirts, are woven (made from cloth), while 40% are knitted (they include T-shirts, for example). In order to qualify for GSP or EBA benefits, these garments must meet the rules of origin, which are an integral element of these schemes.

And the plain fact is that while Bangladesh's garment industry can meet these rules in the case of knitted garments, it is largely unable to do so in the case of woven garments. This is clear from the following Table:

Garment exports from Bangladesh, India and Pakistan 2000 and 2001 (in million euro):

	Bangladesh		India		Pakistan	
	2000	2001	2000	2001	2000	2001
Knitted	826	1,030	702	802	188	192
Woven	162	237	876	903	269	324

Source: EuroStat

The rules of origin require a two stage transformation (yarn to fabric and fabric to garment). They also stipulate that the import content must be less than 50% of the customs value, if the goods in question are to enjoy preferential treatment. While Bangladesh can meet the rules of origin in the case of knitwear, it cannot do so in the case of woven garments, as country's textile mills can supply around 20% only of the garment industry's requirements. The industry, in other words, must rely on imports, unlike its Indian or Pakistani counterpart.

The obvious solution is to import the cloth from India or Pakistan. Under the regional cumulation rules adopted by the EU, inputs sourced from other members of the South Asian Association for Regional Co-operation (SAARC)* are considered as originating in the exporting country – in this case Bangladesh – since October, 2000. (The aim of regional cumulation is to encourage regional co-operation, if not integration. It also applies to the members of ASEAN, the Association of South-East Asian Nations.)

The benefits of cumulation are evident. They enable exporters to take advantage of GSP treatment by acquiring originating status for products which would not qualify otherwise under the EU's rules of origin. The President of the Dhaka Chamber of Commerce and Industry, Matiur Rahman**, maintains, however, that benefits to the country's ready-to-wear industry of cumulation are just 1.92% until 2005, whereas the cost of importing fabrics represents some 5% to 7% of the cost of the fabric.

The situation will change in Bangladesh's favour from 2005, according to Mr. Rahman. Although quotas will disappear with the expiry of the WTO Agreement on Textiles and Clothing (ATC), Bangladesh will continue to enjoy duty-free access to the EU market. This could encourage Indian and Pakistani firms to relocate part of their textile and garment production in Bangladesh, opening up a whole new era of co-operation. The benefits of such economic co-operation could extend to the political sphere also, in Mr. Rahman's view.

He is the first to admit, however, that this "bright and optimistic picture" is unlikely to materialise quickly. The preferred solution, from the Bangladesh government's point of view, is an amendment to the



rules of origin, reducing the value addition or local content requirement from 50% to a much lower figure. Canada, for example, has set the value addition requirement at 25% for garments. This concession, which would be available to least developed countries only, could be withdrawn in time – say in five years' time – as their industrial base widened. The EU accepts that the least developed countries, including Bangladesh, cannot be expected to benefit fully from the EBA at this stage without changes to the rules of origin. It appears reluctant to introduce these changes, however, on the grounds that this could result in a wave of protests from other GSP beneficiaries. After all, the extension of the so-called “drugs regime” to Pakistan has been challenged by India and Thailand in the WTO.

The issue which is currently exercising minds in the European Commission is one that does not concern the least developed countries, not even Bangladesh, despite the rise and rise in its knitwear exports. It is the issue of graduation. Is the EU punishing successful exporters when it withdraws GSP benefits from them through the graduation mechanism? Or is the loss of GSP benefits no more than a recognition of the fact that they are no longer needed, a badge of honour, in fact? ■

*The seven SAARC countries are Bangladesh, Bhutan, India, Nepal, the Maldives, Pakistan and Sri Lanka.

***Bangladesh Quarterly*, June, 2002.

Is Europe Losing Out in Trade with China?

by Duncan Freeman

More than one year after its accession to the World Trade Organisation (WTO), some of the trends in the development of China's trade are becoming clearer. While progress in implementation is generally regarded as being positive, there remain many points of difficulty. WTO accession was broadly welcomed in Europe, particularly by the business community, which saw membership as opening up new opportunities for trade and investment. However, the European Union's performance in its trade with China has not matched expectations in the past year. The 15-nation EU in fact has fallen behind the overall rate of growth of China's foreign trade, especially as regards Chinese imports.

The exports of some EU countries have even declined. On the face of it, this seems strange at a time when the Chinese economy is growing rapidly, its foreign trade

is booming and many trade barriers, such as tariffs are being lowered as a result of WTO accession. Given that all of its trading partners face the same market conditions, this has given some business leaders to question whether Europe is under-performing in its trade with China. While there is no doubt that some European countries could do better, recent trade patterns have been affected by specific factors, which probably make Europe's performance appear worse than it actually is.

EU exports to China were worth US\$38.5 billion in 2002, an increase of 7.9% over the previous year, according to Chinese customs statistics*. This increase should be seen in the context of an overall increase in China's imports of 21%, to US\$295 billion. China's exports to the EU meanwhile grew by 17.9%, to US\$48.2 billion, at a time when China's overall exports grew by 22.3% to US\$325.5 billion. In other words, EU imports from China grew broadly in line with, though somewhat more slowly, than the overall increase in China's exports. EU exports to China fell far below the overall rate of growth, however.

On the face of it, the EU seems to be losing out in its trade with China, particularly as regards its exports to China. Though the EU's large, but not excessive, trade deficit with China has grown, this is not a critical issue. The fact is that many EU countries have surpluses in their trade with China, and it is only the UK and the Netherlands that have significant deficits in their merchandise trade with China. The more important question, therefore, is whether the EU really is losing ground on the Chinese market to its competitors.

Taken individually, some major EU countries have performed much worse than the overall picture shows, while others have done much better. Exports from the UK, which is China's second largest trading partner in Europe, declined by 5.4% (partly because of the strength of sterling). But exports from Greece, Luxembourg, Sweden and Finland also fell, in the last case by 36.3%. Other major traders with China have done better; the UK in fact was the only one of China's very large trading partners to record a decline. Thus exports from France grew by 3.6%, from Holland by 7.9%, and from Italy by 14%. Germany, China's largest trading partner in Europe, did even better, increasing its exports by 19.3%. The picture is not entirely negative, therefore.

Clearly, the performance of individual EU countries in their trade with China is not uniform. It depends to a large extent on the strengths and weaknesses of different sectors of the various economies. Indeed, a closer look at the overall comparative performance of EU countries in 2001 suggests that it is better than one might imagine at first glance. Their trade with China has been affected by two factors, one involving an absolute decline and the other a relative decline. Both

these factors represent, however, specific circumstances, beyond the control of European businesses, and do not necessarily reflect a failure on their part to compete successfully in the Chinese market.

EU Trade with China (US\$ million)

	Imports	Change (%) 2002/2001	Exports	Change (%) 2002/2001
Austria	481	36.1	892	34.9
Belgium	2876	13.7	2022	17.5
Denmark	917	2.1	637	1.8
Finland	1153	26.7	1512	-36.3
France	4072	10.5	4253	3.6
Germany	11372	16.6	16428	19.3
Greece	731	5.5	55	-5.9
Holland	9108	25.1	1571	7.9
Ireland	770	45.3	689	12.6
Italy	4827	20.9	4319	14
Luxembourg	51	31.7	49	-13.8
Portugal	300	15.5	82	15.7
Spain	2578	14	900	26
Sweden	910	-2.3	1791	-17.6
UK	8060	18.9	3336	-5.4

The absolute decline has occurred as a result of the collapse in the exports, from virtually every major EU economy, of one particular sector, telecommunications equipment and other related forms of technology. Chinese customs statistics show that in 2002 imports from the UK of the category of goods that includes telecommunications equipment declined by 72.6%, from Germany by 38.1%, France 19.8% and Italy 60.6%. Only the Netherlands, among China's major trading partners, managed an increase of 10.2%; but this is a relatively much less important sector for the Dutch. For smaller EU countries, a decline in exports to China can have a huge impact, as in the case of Finland, whose exports fell by 36.2%. The 15 EU countries collectively experienced a decline in their exports to China of 49.9%, and this in a category which had accounted for about 10% of their exports to China in 2001.

European exporters are not alone in facing difficulties in this sector. Exports from the US declined by 39.5%. When compared with the US, the economy with which it has the closest parallels, the EU's performance in China in 2001 looks perfectly normal, and even quite positive, given that US exports to China in this sector grew by only 3.9% in 2002.

The explanation for the decline Chinese imports in the telecoms sector is likely to be twofold. It can be seen

as a consequence of the ending of the worldwide Internet/telecoms bubble, which has affected China also, even if to a lesser degree than other countries. It can also be seen as the result of increasing investment by foreign companies in manufacturing facilities in China, as well as improvements in China's own domestic capability to produce the equipment it requires. If this sector is stripped out of EU exports to China, then its export performance looks much stronger. Many other sectors have been marked by strong growth. It is the absolute decline in the telecoms sector, however, which has helped create the general impression of a weak performance in the Chinese market.

The relative weakness of EU trade with China stands out when a comparison is made with Asia. China's trade with a number of key Asian economies increased well above the rate for total trade in 2002. Its exports to the major ASEAN economies grew very fast – as did its imports from these countries. Malaysia, for instance, experienced a 54.5% rise in its imports from China, while its exports to China rose by 49.8%. The Philippines, often considered one of the weaker Asian economies, managed to increase its exports to China by 65.4%. Singapore, Thailand and even Indonesia witnessed a significant rise in their trade with China. Trade between mainland China and Taiwan also grew rapidly. In almost every case the growth was in both imports and exports. While Japan and Korea also managed strong growth, the focus in their case was more on exports to China.

This does not mean that the EU is losing out to Asia, as European and Asian economies are not in direct competition with each other. What appears to be taking place is a fundamental qualitative shift in the nature of China's trading relations with other important Asian economies. Here the most important factor is the increasing integration of the mainland Chinese economy with South East Asia and Taiwan. This is a group of countries that is enjoying a boom in trade with China.

The plain fact is that manufacturing in Asia is increasingly becoming a regional affair, with different stages of the manufacturing process being carried out in different countries, and China emerging as the key player in this process. Chinese statistics show that imports from Malaysia, Philippines, Singapore, Indonesia and Taiwan of electrical machinery, apparatus and their parts grew by 65.4% in 2002, while China's exports to this group of countries, although significantly smaller, grew by 41.9%. These figures suggest that the region as a whole is benefiting from this increased trade. China, in other words, is not a black hole sucking in investments, to the detriment of other countries in the region. Given economic, and especially geographic, realities, such integration within Asia will create patterns of trade that are different from

those between Europe and China. While Europe will not enjoy the same position in its trade with China, many European companies manufacturing or outsourcing in Asia will nevertheless reap the benefits of this Asian economic integration.

The result, perhaps paradoxically, is that the chief beneficiaries of China's accession to the WTO do not seem to be the US and the EU, which played the leading role in pressing China to open up its markets to imports. However, the EU's comparatively poor performance, and the boom in trade within Asia, appear to have little to do with the changes resulting from China's WTO membership. They are more the conjunction of two factors: the downturn in certain sectors of trade and what may turn out to be a historic leap in the integration of the Asian economy. No hasty conclusions should therefore be drawn from the EU's failure to compete in China. ■

*This article relies on Chinese customs statistics for the sake of uniformity, even though these statistics do not really reflect the full picture, particularly as regards trade with China conducted through Hong Kong.

Duncan Freeman is a freelance journalist and consultant based in Brussels.

Trading with Asia: 1958 to 2001

by Dr Willem van der Geest

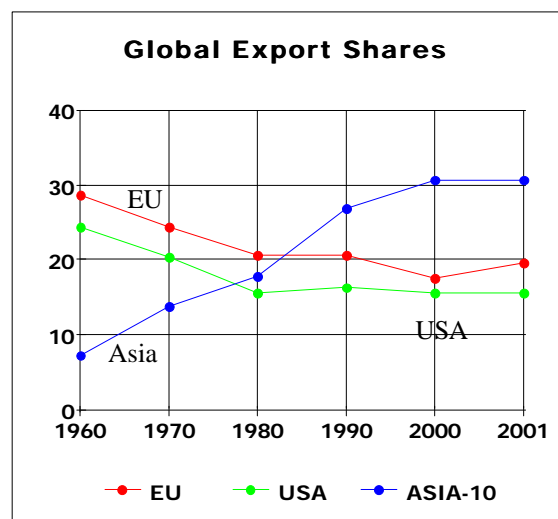
Some political scientists are fond of arguing that trade statistics are the ultimate proof that economics is merely for the dull and insipid. Trust the European Commission's Statistical Office, Eurostat, to prove them wrong. With a great deal of flair its statisticians have just put out an exciting publication on the external trade of the European Union (née European Economic Community), containing time-series starting from 1958, the year the six-nation EEC was established under the Treaty of Rome*.

Today's world does not look even remotely like the post-war scene, which was characterised by Europe's trade deficits, financed by concessional borrowing from the United States under the Marshall Plan. Otrusive and forbidding though the Eurostat Tables may be, they tell a fascinating story. It is about the increasingly rapid emergence, as a global trading power, of Asia, particularly China, rather than the EU. It also shows why the Asia-Europe summit (ASEM) is important.

Let's review the evidence through a few stylised facts.

- World trade grew from 70 billion euro-equivalent in 1958 to well over €5 trillion in 2001 – by some 72 times in monetary terms, over just 42 years.
- Nevertheless, 2001 was the first year which saw a substantial decrease in the value of global trade – it fell by 5.5 per cent, after decades of continuous growth.
- Neither the US nor the European Union (despite its successive enlargements) out-performed the rest – indeed they both lost in terms of their share of world trade: the US was down from 24 per cent to 16 per cent, the EU down from 29 to 20 per cent.
- Some 10 Asian countries had become major global players by 2001. They were, in order of importance of their exports: Japan, China, Hong Kong, South Korea, Malaysia, Thailand, Indonesia, India and the Philippines. *EurAsia Bulletin* readers will recognise that this list bears a striking resemblance to the Asian membership of ASEM – except India.
- Of these Asian-10, some five countries did not account for even one-tenth of one per cent of world exports in 1957, when the Treaty of Rome was signed. They were China, Korea, Malaysia, Indonesia and the Philippines.
- The total share in world trade of the Asia-10 was a modest 7 per cent in 1960. It had doubled by 1970, and doubled once again, to 27 per cent, by 1990 – when the Asia-10 overtook both the EU and the US.
- In 2000 more than 30 per cent of global exports originated in the Asia-10 by value. This was close to the 33 per cent which the EU and US achieved together.

Table 1 and the graph sum up these stylised facts.



Since the European Economic Community was set up in 1958, it has been successively enlarged from EEC-6 to EU-10 by 1981. Since 1995 it has remained at EU-15, but will jump to EU-25 in May 2004. How have



these enlargements changed the EU's external trade balance? The Eurostat time-series provides us with some clues as to how the global shifts in trade interacted with the regional integration proceeding within the EU itself.

Standard economic theory would suggest that the enlargement of a customs union would stimulate trade within its frontiers, at the expense of imports from outside the customs area. The trade deficits registered by EU-6, grew much larger with EU-10. However, by 1986 the EU expanded to 12 Member States, and during 4 out of the 9 years it recorded trade surpluses. With the further expansion to EU-15 in 1995, the EU has managed a modest trade surplus during 3 out of the 6 years to 2001.

These surpluses amounted to between €20 billion to €50 billion, while deficits during the other three years were comparatively manageable – certainly no greater than those experienced during the 1980s. If we aggregate over the six years for which we have EU-15 data, we could reasonably argue that EU-15 is now genuinely close to a zero-trade balance. In other words, the evidence of the EU times-series seems generally supportive of this basic notion of economic integration.

If we look at the pattern of inter-regional trade balances, we can note the following stylised facts:

- The EU has always had significant trade deficits with the USSR, Japan and China.
- While its deficits with Russia and China have continued to grow, those with Japan, as well as with the four Asian tigers, appear to have remained stable since the late 1990s.
- Since the EU's 1995 enlargement, its trade surplus with the North American Free Trade Area (NAFTA) has grown significantly, reaching some €55 billion in 2001.

A thorough analysis of the economic impact of enlargement on the rest of the world is needed. An analysis of the likely impact of the forthcoming enlargement to EU-25 on patterns of global and inter-regional trade is even imperative. Will the Asia-10 continue to run substantial trade surpluses with the EU, and the EU will register trade surpluses with NAFTA? Or will trade diversion cause downward pressure on EU imports? If so, how might enlargement impact on global trade and growth? ■

Dr Willem van der Geest is Director, European Institute for Asian Studies, Brussels.

Table
Evolution of Global Exports 1960-2001 (Euro Billion equivalent)

	1960	1970	1980	1990	2000	2001
World Exports	84.1	211.6	1016.1	1885.4	5342.6	5044.3
% of which						
European Union**	28.7	24.3	20.7	20.7	17.6	19.5
United States	24.4	20.4	15.6	16.3	15.6	15.7
Asia-10	7.4	13.8	17.9	26.8	30.7	30.7
<i>Of which</i>						
Japan	4.6	8.9	9.2	11.9	9.6	8.3
China	0	0	1.2	2.6	5.0	6.9
Hong Kong	0.7	1.1	1.3	3.4	4.0	3.7
South Korea	0	0.3	1.2	2.7	3.4	3.2
Singapore	0.2	0.7	1.3	2.1	2.8	2.5
Malaysia	0	0.7	0.9	1.2	1.9	1.9
Thailand	0.4	0.3	0.4	0.9	1.3	1.3
Indonesia	0	0.5	1.5	1.0	1.2	1.3
India	1.5	0.9	0.5	0.7	0.8	0.9
Philippines	0	0.4	0.4	0.3	0.7	0.7

**Exports from EU Member States to non-EU countries

*See *Commerce Extérieur et Intra-Union Européenne- Annuaire Statistique: Données 1958-2001*, Eurostat 2002. The volume covers global trade, trade with major partners, trade by product type and trade by EU Member States.