

European Community Tariff Preferences and Foreign Direct Investment *

1. Introduction

The effects of non-discriminatory tariff changes on a multinational firm's choice between exports and foreign production in the servicing of an established market have been extensively documented in historical and statistical studies (reviewed in Caves, 1982, pp. 40-41) and analysed rigorously by Horst (1973). Much less analysed and only to a limited extent statistically investigated is the impact of discriminatory tariff changes of a non-reciprocal character on the locational choices of multinational enterprises (MNEs).

Non-reciprocal geographically discriminatory tariff reductions have been widely used to provide improved market access to all or selected groups of exporters from less developed countries. The Generalised Systems of Preferences (GSP) offered by several developed market economies, the Lomé convention of the EC covering a wide range of export items of the associated African, Caribbean and Pacific states (ACP) and the development cooperation agreements of the EC with the Maghreb and Mashrek countries in the Mediterranean region are examples of discriminatory tariff preferences of a non-reciprocal nature. The GSP discriminates against other industrialised countries and the centrally planned economies of Eastern Europe whilst the Lomé convention and the Mediterranean agreements of the EC discriminate both against the above groups of countries and a host of other "less privileged" developing nations particularly in Asia and Latin America.

The tariff realignments brought about by such preferential trading arrangements give rise to both trade creation and trade diversion

* The helpful comments of my colleagues J. Cantwell and M. McQueen are thankfully acknowledged.

effects. Trade diversion implies a market loss for the third country, non-preferred, producer exporting to the preference granting region. A possible response of a threatened third country exporter is direct investment in the preference receiving region for the purpose of establishing production facilities there to service the market of the preference granting region. The investment flow generated from outside the preferential trading area as a direct response of the trade diversion effects of the discriminatory tariff changes is known as the investment creation effect of preferential trading. Trade creation and the new opportunities for specialisation it creates call for the reallocation of production facilities. This reallocation may entail relocation of production facilities from the preference granting region (operated either by third country MNEs or donor country firms) to the preference receiving region. Thus in response to the trade creation effects of preferential trading arrangements investment reorganisation within the preferential trading area will be required. This is the investment diversion effect of preferential trading (Kindleberger, 1966, p. 65). Investment diversion is foreign-direct investment generated in response to the stimulus of trade creation to which the preferential trading arrangement gives rise.

When non-reciprocal tariff preferences are present the main type of foreign direct investment likely to be affected is the export platform kind. Investment of the import-substituting type will only be indirectly affected in the sense that this kind of foreign direct investment in the donor countries may be displaced by export platform foreign direct investment in the beneficiary countries once preferential trading arrangements are established. It is with these types of foreign direct investment that we are primarily concerned in this paper.

The paper offers in section two an analytical framework within which the implications of non-reciprocal tariff preferences on the locational strategies of MNEs are directly derived from the theory of economic integration and preferential trading. The final section looks at the pattern of foreign direct investment in the countries that are recipients of EC tariff preferences and examines how far it provides support for the hypotheses presented in section two.

2. Tariff Preferences and Foreign Direct Investment: The Links

The purpose of this section is to examine the impact of non-reciprocal tariff preferences made available to selected groups of countries (*i.e.* geographically discriminatory rather than universal) on the relative size, the industrial structure and the geographical origin of the foreign direct investment flows to beneficiary countries. It will be demonstrated that the size and direction of the foreign direct investment flows generated from the establishment of this type of preferential trade arrangement are determined by the strength of the trade creation and trade diversion effects of the changes in the structure of tariffs, the previous patterns of servicing donor country markets and the differences in ownership specific advantages between beneficiary country firms and firms originating from either the donor or third countries.

The links between tariff preferences and foreign direct investment are established in three distinct steps. The section looks first at the size and the structure of the export opportunities arising from the availability of non-reciprocal geographically discriminatory tariff preferences. Then it examines the factors that determine whether the resulting export opportunities will be taken up by indigenous or foreign firms. Finally, it asks how far the balance between the trade creating and the trade diverting effects of the tariff preferences may exert an influence on the distribution of the resulting foreign direct investment between preference granting and third countries.

Tariff preferences can give the beneficiary country significant competitive advantages. As Johnson (1968) argued when this competitive advantage is correctly measured by the percentage difference it makes to value added to raw materials and other inputs in the production process it turns what might appear a "small" preferential advantage when measured as a per cent of the price of the final product into a large advantage. Indeed such preferences will give rise to a windfall bonus or economic "rent" which will accrue to exporters from the beneficiary country. The size of this windfall gain will depend on the demand conditions that exports from the beneficiary country are faced with in the markets of the donor countries. This windfall gain represents a redistribution of income from the government of the donor country to the exporter in the beneficiary country.

In terms of the OLI paradigm (Dunning, 1981), tariff preferences enhance the locational advantages of the beneficiary country but do not

directly affect either firm specific ownership advantages or the size of the internalisation benefits.

The enhanced locational advantages of the beneficiary country will not by themselves be sufficient to generate foreign direct investment flows from either the donor or third countries. For this to happen foreign firms must possess ownership specific advantages that can place them in a position to capture the new export opportunities in competition with indigenous firms in the unfamiliar environment of the beneficiary country. D'Arge (1969) writing in the days before the emergence of the modern theory of the multinational enterprise provided an explanation by pointing out to prevailing differences in the magnitude of the direct (and cross) supply elasticities of foreign direct investment to changes in expected rates of profit in both donor and beneficiary countries. However, it is important to go one step further and enquire into the factors that determine the magnitude of these elasticities.

Differences in the degree of responsiveness of foreign and indigenous enterprises to changes in the expected profitability of export production from beneficiary country locations will be crucially influenced by two major factors. The first is the type of skills and resources required for the production of the additional or new exports generated through the availability of tariff preferences. The second is the extent to which the expansion of exports stimulated by the tariff preferences requires a large proportion of inputs from outside the beneficiary country.

Accessibility to, and the cost of, the resources and skills required for export production may vary systematically between indigenous and multinational enterprises. These differences will be important if the relevant skills and/or resources are of the type where the dominant method of transfer is the internal transaction mechanism rather than the market transaction mechanism. It is well known from the modern theory of international production that the advantages of internal over market transfer is substantial for transactions involving the transfer of specialised information. Thus if the new export production stimulated by tariff preferences requires the use of specialised informational assets that are transferable through intra-firm mechanisms then foreign firms are likely to dominate the resulting export expansion. If the export expansion effects of tariff preferences are concentrated in sectors where the marketing, management or technological intensity of production is high (and therefore involve the use of specialised informational assets transferred through internal transaction mechanisms) one would expect

that tariff preferences will give rise to relative large investment creation and/or investment diversion effects. It follows that the product coverage provisions of the preferential trading arrangements (PTAs) and the country characteristics of the beneficiaries are important in determining the potential size of investment creation and/or investment diversion effects.

On the assumption that preferences involve across the board tariff cuts (or removals) then one would expect that their trade creating and trade diverting effects will manifest in those sectors and products where the country specific comparative advantages of the beneficiaries are concentrated. If the countries that are recipients of tariff preferences are at a relatively early phase of their industrialisation then following the "stages" approach to comparative advantage (Balassa, 1982) one can reasonably hypothesise that the preference induced export expansion effects will be particularly strong in the trade of goods that are relatively intensive in the use of unskilled or semi-skilled labour inputs and which are produced with the use of standardised or unosphisticated technology (Yannopoulos, 1986).

In such circumstances and given what we know about the kinds of production that may be switched from developed to developing countries locations one would expect very little participation of foreign direct investment in the export expansion effects stimulated by PTAs. However, this may be a sweeping generalisation since we are dealing here with export activities in fairly sophisticated markets where marketing skills are of considerable importance. Thus the more important are the marketing skills and knowledge required to overcome the marketing entry barriers in the donor countries the more pronounced will be the advantage of the foreign firms (De La Torre, 1974). Given that marketing skills are relatively scarce resources in developing countries the marketing characteristics of the products covered by tariff preferences are perhaps the most crucial factors in determining the relative importance of foreign direct investment in the growth of the tariff stimulated export oriented production. Even products using fairly standardised technology like clothing or footwear may demand superior market knowledge and marketing skills when sold in markets where promotional levels, complexity of distribution channels etc. create fairly moderate marketing entry barriers. In such cases the proportion of domestic specific information required for efficient local production will be relatively small so that foreign firms (provided they are not constrained by legal barriers) can effectively compete with indigenous

firms in the export oriented production activities stimulated by the introduction of tariff preferences. Thus one can postulate that:

- I. The higher is the marketing intensity of production in the sectors whose export activities have become more profitable by the availability of preferences the larger will be the proportion of foreign direct investment originating from either third countries (in the case of a trade diverting PTA) or from the donor countries (in the case of a trade creating PTA) channelled to the beneficiary countries in comparison to the situation prevailing before the introduction of the PTA.

Similar implications follow if the managerial and/or technological intensity of the export production stimulated by the availability of tariff preferences is relatively high. But given the country characteristics of preference recipients this is unlikely to be the case in practice, since research and innovation is to a large extent country specific as well as firm specific.

Far more important in determining the share of the export expansion effects of tariff preferences likely to be captured by foreign (non-local) MNEs is the proportion of the required inputs that must be supplied from outside the beneficiary country. This is so because the costs of scanning international markets for inputs will be lower for the MNE. Thus a second proposition follows *i.e.*:

- II. The share of foreign firms in the export-oriented production stimulated by the availability of preferences will tend to be larger the larger is the share of inputs in that type of production purchased from outside the beneficiary country.

The literature on MNEs has extensively demonstrated that the costs of scanning the international environment and acquiring information about foreign locations tend to be relatively lower for firms of large size. It can thus be postulated additionally that:

- III. The larger is the absolute size of the firms producing for the home market of the MNEs the type of products for which non-reciprocal tariff preferences become available, the relatively larger will be the investment creation and investment diversion effects resulting from such preferences.

Let us now examine in more detail how the distribution of the export expansion effects between trade creation and trade diversion will determine whether the foreign direct investment will be undertaken by MNEs from donor or third countries. One crucial factor in determining the response of firms within and outside the preferential trading area to changes in tariff structures is the extent to which the market of the donor country has been supplied before the PTAs by foreign firms through exports from outside the PTA, or by foreign firms through production within the PTA or by indigenous firms from the donor country.

The response of firms in each of these cases to both the trade creation and the trade diversion effects of PTAs are shown in the Table 1.

The table deals with three extreme cases where the donor market for a particular product is served entirely either by exports from outside the PTA (case C), or by indigenous firms of the donor country or by foreign firms already operating production facilities within the PTA. When the market is served by a combination of these options then the enactment of a preferential trading arrangement may give rise to both trade creation and trade diversion effects. The presence of trade diversion in cases a2 and b2 or a3 and b3 may assist firms already with production facilities in the beneficiary country to capture the export trade of the third country. Their familiarity with the production environment of the beneficiary country provides them with specific informational assets that enable them to thwart any attempts by the outside MNE to maintain its market share in the donor country through production from the beneficiary country. Such ownership specific advantages are not possessed when alternatives a1 or b1 are used; in such cases the outcome is uncertain.

The presence of trade creation in case c1 is unlikely to result to the foreign firm from outside the PTA area capturing the resulting export opportunities. Trade creation is the replacement of relatively less efficient production within the donor country by relatively more efficient production within the beneficiary country. Let us first take the case where, before the tariff preferences, donor country markets were served by indigenous, donor, country firms. Presumably, these firms produced there because their ownership specific advantages were strong enough to enable them to repel other MNEs to capture that market. Outside MNEs will thus be at a distinct disadvantage to be able to profit from the relocation of production brought about through the granting of tariff preferences, unless the locational advantages of producing in the beneficiary countries are perceived more easily and more speedily by MNEs from outside the PTA.

TABLE 1

ALTERNATIVE MODES OF INTERNATIONAL INVOLVEMENT UNDER TRADE CREATING AND TRADE DIVERTING PREFERENTIAL TRADING ARRANGEMENTS

<i>Method of Servicing the Market</i>	<i>Choice of Mode</i>
CASE A. Market of Donor Country Served Originally by Indigenous Firms.	
1. Response under Trade Creation	
a1. market served from locations within the donor country	(i) relocation of production facilities to the beneficiary country (ii) joint ventures with local firms in the beneficiary country (iii) closure
a2. market served by exports from the beneficiary country	expansion of production facilities located in the beneficiary country
a3. market served from plants located in the donor country but firms possess also production facilities in the beneficiary country	(i) redistribution of affiliate production and increase in intra-firm trade (ii) complete relocation and/or closure of donor based production facility.
2. Response under Trade Diversion: Not applicable	
CASE B. Market of Donor Country Served Originally by Foreign Firms with Production Facilities Inside the PTA.	
1. Response under Trade Creation	
b1. market served by production within the donor country	(i) relocation of production facilities to the beneficiary country (ii) joint ventures with local firms in the beneficiary country (iii) closure
b2. market served by production from the beneficiary country	expansion of production facilities in the beneficiary country
b3. market served by production facilities in the donor country but MNE possesses additional production facilities in the beneficiary country	(i) redistribution of subsidiary production and increase in intra-firm trade (ii) closure of production facility in donor country.
2. Response under Trade Diversion: Not applicable	
CASE C. Market of Donor Country Served Originally by Exports from Outside the PTA.	
1. Response under Trade Creation: Not applicable	
2. Response under Trade Diversion	
c1. market supplied by exports from third countries	(i) establishment of production facilities in the beneficiary country (ii) joint venture with local firms in the beneficiary country (iii) withdrawal from the market (iv) reduction of price.

The upshot of this discussion can be summarised in terms of a straightforward proposition that can easily be converted into a testable hypothesis:

- IV. The higher is the size of the trade created relative to trade diverted in a PTA the larger will be the share of foreign direct investment originating from the donor countries in the total foreign direct investment received by the beneficiary countries.

In this case the major part of the foreign direct investment will come either from the relocation of production between donor and beneficiary or from the expansion of production facilities owned by donor country firms in the beneficiary country. Such investment is likely to be by MNEs from the donor country since they are likely to possess the appropriate ownership specific advantages to compete effectively with third country MNEs to exploit the new export opportunities.

Proposition IV needs obviously modification in case the donor country's market was already served before the PTA by local subsidiaries or production branches of third country MNEs. In such case, the trade creating effect of tariff preferences may give rise to foreign direct investment originating from outside the region covered by the PTA.

3. Some Tentative Evidence from European Tariff Preference Schemes

The quality of published statistics on foreign direct investment flows and/or stocks in the countries benefiting from EC non-reciprocal tariff preferences is far from adequate for formally testing the hypotheses advanced in section two. Data from the EC's Yearbook of ACP statistics provide information at the appropriate level of geographical (but not sectoral) detail only for private financial flows and not separately for foreign direct investment. The 1983 survey of the UN CTC provides information on numbers of foreign affiliates by country of origin for a fairly large number of ACP countries and for most of the countries included in the Mediterranean policy of the EC. But even this insufficient information is available for one single year.

This section, therefore, will utilise several secondary sources of fragmented evidence and a number of case studies in an effort to build up a collage of evidence to be compared to the picture given in section two.

Before any attempt is made to link the patterns of foreign direct investment in the EC's associates with the availability of tariff preferences it is essential to know first the relative size of the trade creation and the trade diversion effects produced by the existing PTAs and secondly the sectoral distribution of the export expansion effects generated by the tariff preferences. Given our previous analysis, the first piece of information is important in order to interpret the distribution of foreign direct investment by country of origin of the MNE whilst the second is important because the industrial characteristics of the sectors where export expansion effects are generated are critical in determining whether these new opportunities will give rise to foreign direct investment activity or to indigenous enterprise expansion.

Earlier investigations into the trade effects of the Yaoundé convention (the agreement that preceded Lomé in the period when the EC consisted of six member states) point out that the direct preferences of this PTA yielded principally trade creating effects. Young (1972) found that the direct preferences of the Yaoundé convention produced windfall gains (through higher export prices) to the exporters of the associated countries equal to around 2.5 per cent of the total exports of the associated countries in 1969 but did not appear to have diverted the EC's import trade from other sources of supply. In other words, the exports of the Yaoundé associates to the EEC were not much different in 1969 than one would have expected given these countries' trade volumes in 1959 (at the start of the PTA) and subsequent growth rates.

Evidence for the export performance of non-Yaoundé countries that joined the ACP group in 1975 following the first enlargement of the EC indicates that during the period of the first Lomé convention (1975-1979) the direct preferences made available to the previously non-associated countries produced relatively small trade creating effects and limited trade diversion against Latin America exports to the EC (Moss, 1982). Relatively limited trade diversion effects are also found in the EC's GSP. Baldwin and Murray (1977) calculated that the EC's GSP led to total trade expansion for the beneficiary countries of \$ 217 million (*i.e.* 25 per cent of all eligible exports) of which only about \$ 17 million was trade diversion. More recent work by Davenport (1986) produces further confirmation of the relatively small trade diverting effects of the EC's GSP. This is not very surprising given the low degree of similarity of the export structures of the beneficiary developing countries and the non-beneficiary industrialised countries. It is for this reason that the evidence for relatively stronger trade diversion effects

appears more robust in the case of the EC associates in the Mediterranean region (Pomfret, 1986).

Given the evidence regarding the relative strength of the trade creating and trade diverting effects of the various PTAs of the EC, the analysis of section two suggests that the EC's tariff preference schemes would have resulted in the EC's share of foreign direct investment within the associated countries to rise as a proportion of total foreign direct investment there. Furthermore, with negligible trade diverting effects, it is likely that the share of third country foreign direct investment channeled to the EC's associates would either remain the same or even decline (D'Arge, 1969).

A summary presentation of the UN CTC survey data (Tables 2 and 3) indicates the dominant position of the EC's MNEs in the number of foreign affiliates located in the associated countries of the Lomé convention and the Mediterranean region.

These data are of course only suggestive and far from conclusive as they reflect the impact of a number of factors operating over a long run period (imperial preferences, cultural ties etc.) rather than the influence of short term developments like the recent PTAs. More appropriate data of investment flows or changes in stocks are not available on a comprehensive basis for the testing of proposition IV above. However, Moss (1982, p. 142) provides an interesting set of comparative US and EC direct investment flows to ACP countries for the decade 1970-79. This information comes closer to the requirements in examining the validity of proposition IV. Indeed, it provides support for it. As can be seen from Table 4 the share of US direct investment in the ACP states in the combined EC and US total declined — as expected — from 58% in the pre-Lomé I five year period to 42% during the first Lomé I. Furthermore, the share of ACP in total US direct investment flows to all developing countries declined during 1975-78 compared with the period immediately preceding Lomé I as shown from the following US Department of Commerce statistics:

	1971	1972	1973	1974	1975	1976	1977	1978
%	16	14	97	12	12	6	5	11

In interpreting the above data we postulate that changes in trade patterns and in particular the interplay of the trade creating and the

TABLE 2

EC SHARE IN THE NUMBER OF FOREIGN AFFILIATES OF MNEs
IN SELECTED ACP HOST COUNTRIES

Less than 20%	Jamaica, Liberia
21%-40%	Bahamas, Papua New Guinea, Vanuatu
41%-60%	Barbados, Trinidad and Tobago
61-80%	Ghana, Guinea, Guyana, Nigeria, Suriname, Zambia
81%+	Benin, Botswana, Cameroon, Congo, Ethiopia, Gabon, Ivory Coast, Kenya, Madagascar, Malawi, Mauritius, Senegal, Sierra Leone, Swaziland, Tanzania, Togo, Uganda, Zaire

Source: UN CTC, *Transnational Corporations in World Development: Third Survey*, New York, 1983.

TABLE 3

EC SHARE IN THE NUMBER OF AFFILIATES OF MNEs
IN SELECTED MEDITERRANEAN HOST COUNTRIES

Country	Percentage
Algeria	73.1
Cyprus	81.2
Egypt	53.6
Israel	25.2
Lebanon	51.0
Malta	84.4
Morocco	77.8
Tunisia	83.0
Turkey	55.2

Source: UN CTC, *Transnational Corporations in World Development: Third Survey*, New York, 1983.

TABLE 4

COMPARATIVE EC AND US INVESTMENT PERFORMANCE IN THE ACP COUNTRIES

Period	Annual Average Flows in billions of 1977 US\$ and 1977 exchange rates			Share of US in combined total (%)
	US	EC	US+EC	
1970-74	0.65	0.48	1.13	58
1975-79	0.30	0.42	0.72	42

Source: OECD Development Assistance Committee as given in MOSS (1982) p. 142.

trade diverting effects of PTAs stimulate subsequently changes in foreign direct investment patterns. However, it is conceivable that the causal link may work in the opposite direction. Whatever the direction of the causal link foreign direct investment in ACP has positively contributed to the expansion of their export capacity and thus assisted them in taking advantage of the export-facilitating framework of the PTA of Lomé.

In a cross-section analysis involving 44 ACP countries, Agarwal *et al.* (1985) found that up to 32 per cent of the variations of ACP export shares in total developing countries exports can be explained by variations either in the ACP countries' share of the foreign direct investment stock in developing countries or in their corresponding share in the number of affiliates.

Another approach that can be used to examine whether foreign direct investment has enhanced capacity to take advantage of the improved access conditions in EC markets is to see the extent to which the share of foreign direct investment in gross domestic capital formation is directly related to the degree of export diversification when non-reciprocal tariff preferences are available. Stevens and Weston (1984) have produced a list of ACP states which during the period 1975-80 succeeded in adding on a sustainable basis at least 5 new items in their list of exports of manufactured goods to the EC.

Table 5 gives a list of the ACP countries where the share of foreign direct investment in gross capital formation is around or above the average for the ACP group as a whole. An asterisk to the left of name of the country indicates that the country did succeed in diversifying its export base during the period of Lomé I. As can be seen from this table with the exception of six countries (four of which are clearly resource rich with a large part of foreign investment in mineral processing operations) the other eight are included among those with a sustainable export diversification record.

Evidence on the sectoral distribution of the export expansion and export diversification effects of tariff preferences is presented in Stevens and Weston (1984) for the ACP countries and in Yannopoulos (1986) for the associated Mediterranean countries. The products where the export expansion effects of trade preferences appear to be strong are especially consumer semi-durables (garments, shoes etc.) followed by processed industrial supplies (essentially semi-manufactures) and parts and accessories of transport equipment. These are sectors where product differentiation is limited and where theory would suggest that

TABLE 5

ACP STATES WITH AVERAGE OR ABOVE AVERAGE SHARE OF FOREIGN DIRECT INVESTMENT IN GROSS DOMESTIC CAPITAL FORMATION (1980)
(An asterisk denotes success in export diversification during 1975-80)

Country	Share (%)	Country	Share (%)
* Barbados	4.2	Niger	3.4
* Central African Republic	2.1	Papua New Guinea	5.6
* Cameroon	1.9	Sierra Leone	1.9
* Gabon	1.8	* Swaziland	2.6
* Kenya	3.1	* Trinidad and Tobago	1.8
Liberia	23.7	* Zaire	9.3
* Mauritius	2.1	* Zambia	5.2

Source: Compiled from AGARWAL *et al.* (1985) STEVENS and WESTON (1984).

foreign direct investment of the horizontal type is likely to be negligible. This does not appear to be the case however as far as the experience of both the ACP and the Mediterranean countries are concerned. For example, in a study of the sectoral distribution of French foreign direct investment in 13 francophone ACP states, Langhammer (1977) found that more than half of the foreign direct investment in manufacturing was in textiles, food products and chemicals. (Manufacturing absorbed $\frac{2}{3}$ of French foreign direct investment in the 13-nation group.) An important factor that differentiates between developed and developing countries as far as the sectoral distribution of foreign direct investment is concerned is the limited marketing knowledge and the lack of marketing skills for export operations that one observes in the developing countries. In addition domestic price distortions in the beneficiary countries may act as a more onerous tax on exports from indigenous firms than on exports from foreign firms' local branches. Hence, the export stimulus of non-reciprocal tariff preferences is likely to produce a higher rate of response from MNEs than from indigenous firms. A few case studies can easily demonstrate this.

Malta and Mauritius are two small island economies where foreign direct investment is unlikely to be attracted by domestic market growth prospects. Following Malta's association with the EC, the share of foreign capital in the clothing industry increased from 57% in 1970 to 85% in 1976 (Pomfret, 1986). More than 80% of Malta's total (non-fur) clothing exports are sold in the EC (of which more than 50% goes to

the German market and originates from branches of German manufacturing firms that have relocated their production facilities in the island during the above period). The case of Mauritius is also very indicative. The government of Mauritius started an Export Processing Zone (EPZ) in the early 1970s before the island state joined the ACP group in 1975. In the earlier period around 60% of all exports from the EPZ went to EC. Since then the share rose to 80%. But in the case of products where preferences did matter the change was more dramatic. Investment in the EPZ of Mauritius is a mixture of investment diversion (*i.e.* relocation of certain processes from the EC) and investment creation (*i.e.* third country, mainly Hong-Kong, investment to overcome trade diversion against non-beneficiaries). A similar case can be documented for the Ivory Coast and for two Maghreb associates, Tunisia and Morocco. In Ivory Coast more than 70% of foreign direct investment in manufacturing since 1975 is of EC origin and corresponds in its majority to investment diversion phenomena (*i.e.* relative relocation of production facilities from the EC). Being already a member of the Yaoundé group the Ivory Coast had experienced at an earlier stage the export expansion effects of tariff preferences but it still sells more than 60% of its total manufacturing exports to the EC. For a number of manufactures where the margin of tariff preferences is of importance the share of exports directed to the EC exceeds 80%.

Tunisia and Morocco both experienced since the early 1970s a fast growth of outwards processing operations in the clothing sector. Joekes (1982) in a well researched piece singled out the preferential trading status accorded to such exports in EC markets as a factor encouraging their development. However, the share of foreign direct investment in the clothing industries of these two countries varies substantially. The share of foreign direct investment in the Tunisian clothing is higher than the corresponding Moroccan share. These contrasting patterns of MNE response to the outwards processing opportunities stimulated through preferential access to EC markets can be explained by the fact that Morocco unlike Tunisia had already by the early 1960s a well established indigenous clothing industry which was ready to take advantage of the export opportunities opened up through EC tariff preferences. Thus in Tunisia as in Malta foreign firms filled the gap.

The increased foreign penetration of a number of industries (which do not produce distinctively differentiated products) like clothing in the case studies cited is as much a consequence of the availability of EC non-reciprocal tariff preferences as it is of the lack of export marketing

knowledge, skills in quality control procedures etc. that place the domestic firms in the beneficiary countries at a disadvantage *vis-à-vis* foreign firms. Thus non-reciprocal tariff preferences give rise to investment diversion and/or investment creation effects, particularly in those cases where the informational assets that are necessary for the exploitation of the PTA stimulated export opportunities are not possessed by indigenous enterprises.

Reading

GEORGE N. YANNOPOULOS

REFERENCES

- AGARWAL, J.P., DIPPL, M. and LANGHAMMER, R.J. (1985), *EC Trade Policies Towards Associated Developing Countries: Barriers to Success*, Kieler Studien, Nr. 193, J.C.B. Mohr (Paul Siebeck), Tübingen.
- BALASSA, B. (1982), *The Newly Industrialising Countries in the World Economy*, Pergamon Press, London.
- BALDWIN, R. and MURRAY, T. (1977), "MFN Tariff Reductions and Developing Country Trade Benefits under the GSP", *Economic Journal*, Vol. 87, pp.30-46.
- CAVES, R.C. (1982), *Multinational Enterprise and Economic Analysis*, Cambridge: University Press.
- D'ARGE, R.C. (1969), "Note on Customs Unions and Direct Foreign Investment", *Economic Journal*, vol. 79, pp. 324-333.
- DAVENPORT, M. (1986), *Trade Policy, Protectionism and the Third World*, Croom Helm, Beckenham, Kent.
- DE LA TORRE, J. (1974), "Foreign Investment and Export Dependency", *Economic Development and Cultural Change*, Vol. 23, No. 1, pp. 133-150.
- DUNNING, J.H. (1981), *International Production and the Multinational Enterprise*, Allen and Unwin, London.
- HORST, T. (1973), "The Simple Analytics of Multinational Firm Behaviour", in M.B. Connolly and A.K. Swoboda (eds.), *International Trade and Money*, London.
- JOEKES, S. (1982), "The Multifibre Arrangement and Outward Processing: the Case of Morocco and Tunisia", in C. Stevens (ed.), *EEC and the Third World: A Survey*, No. 2, Hodder and Stoughton, London, pp. 102-112.
- JOHNSON, H.G. (1968), "LDC Investment: The Road is Paved with Preferences", *Columbia Journal of World Business*, Vol. 3, No. 1, pp. 17-21.
- KINDLEBERGER, C.P. (1966), "European Integration and the International Corporation", *Columbia Journal of World Business*, Vol. 1, No. 1, pp. 65-73.
- LANGHAMMER, R.J. (1977), "Estimating the Stock of Foreign Direct Investment in the Manufacturing Sector of Francophone Sub-Saharan African Countries", *Kiel Working Papers*, No. 54.
- MOSS, J. (1982), *The Lomé Conventions and their Implications for the United States*, Westview Press, Boulder, Colorado USA.
- POMPRET, R. (1986), *Mediterranean Policy of the European Community: A Study of Discrimination in Trade*, Macmillan, London.

- STEVENS, C. and WESTON, A. (1984), "Trade Diversification: Has Lomé Helped?", in C. Stevens (ed.), *EEC and the Third World: A Survey*, No. 4, Renegotiating Lomé, Hodder and Stoughton, London, pp. 27-62.
- YANNOPOULOS, G.N. (1986), "Patterns of Response to EC Tariff Preferences: An Empirical Investigation of Selected non-ACP Associates", *Journal of Common Market Studies*, Vol. 25, No. 1, September, pp. 14-30.
- YOUNG, C. (1972), "Association with the EEC: Economic Aspects of the Trade Relationship", *Journal of Common Market Studies*, Vol. 11, pp. 120-135.