

PRIME MINISTER

INNER GERMAN TRADE

We spoke in the car today about the article you saw on inner German trade.

You may be interested to look through the attached paper on the subject prepared by the Department of Trade and Industry. Its main points are as follows:

- The special arrangements for inner German trade date back to the Berlin Agreement of 1951. They are covered by a protocol to the GATT and another protocol to the Treaty of Rome. The original purpose was to underline support for the FRG's position that the GDR is not a foreign country.
- The basis of the arrangements is that all trade between the two parts of Germany is free of import duty and there are in practice no restrictions on value or quantity (although there is a price examination procedure to prevent dumping by the GDR).
- In addition West German companies which buy from the GDR get a VAT rebate. This in effect amounts to a subsidy of between 5 and 11 per cent on purchases.
- In theory GDR goods which enter the rest of the Community through inner German trade can be made subject to the EC's common external tariff. In practice there is no real possibility of this duty being imposed.
- The loss of revenue in EC tariffs and levies from GDR exports to West Germany is about £130 million, which means a cost to the UK of some £30 million.

- There is also a consideration that the duty free character and tax benefits of inner German trade give an unfair advantage to West German manufacturers, who can buy raw materials and components more cheaply than their competitors.
- It could also be argued that East German goods displace EC exports to the Federal Republic, although the DTI's analysis does not actually show much evidence as regards our main exports.
- Problems may get worse after 1992 as frontier controls on goods are further reduced. We shall want to press the Germans to ensure that GDR goods imported into West Germany and subsequently re-exported elsewhere in the Community attract duties and levies and that VAT rebates on them are forfeited.
- In short the inner German trade arrangements distort competition in Europe and impose a significant loss of revenue. That fact is probably accepted as political necessity by other member states. But at the least we should try to tighten up the existing arrangements.

C.D.P.

(C.D. POWELL)

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