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The Rt. Hon. Nicholas Ridley MP
Secretary of State for Trade and Industry

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Rine Review

A revised
opinion on
Inner-German
Trade.

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Dear Stephen,

INNER GERMAN TRADE

I agreed with Charles Powell that it might be helpful for us to circulate a note on present condition of Inner German Trade, in view of current discussion of the Community's future relations with the GDR. This is attached. The main points to note are that:

- i) IGT has, in practice, largely been in raw materials and semi-manufactured goods. This may provide some economic advantage to the Federal Republic, but IGT represents a very small proportion of supply needs in the FRG, and we doubt whether it gives German manufacturers a real competitive advantage. (This is borne out by the static nature of the trade and the efforts the FRG have to make to encourage it.)
- ii) Although they consider the goods to be in free circulation, the Federal Republic regulates IGT in ways which minimise the leakage into the rest of the EC, and ensure the goods really are of East German origin.
- iii) The FRG therefore estimates leakage to be about 1% of the total trade. Our own experience is that very few of the complaints made to us about IGT can be substantiated.
- iv) Member states can take safeguard action against leakage. We have never needed to do so. This facility may be unworkable after 1992 but the FRG have so far shown themselves willing to find an effective replacement.

Up to now, therefore, we have considered the situation reasonably secure. When DTI and FCO officials discussed it in





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Bonn earlier this year, the Germans were anxious to reassure us that they wanted to maintain strict controls - both now and after 1992. I think we now need to look at this again. Recent developments may have caused some change of view in the FRG; and with the East German economy potentially attracting much West German investment and becoming more competitive, there must be a chance that leakage will start to grow and the Germans determination to control it will diminish. I think therefore that it would be useful for our official to make further contact with the IGT office in Bonn to probe current thinking and subsequently to keep a very close watch on the situation. My officials will be in touch with yours about this.

I am copying this letter to Charles Powell, to Private Secretaries to Cabinet Ministers, to Trevor Woolley and to Sir David Hannay.

Yours are

Neil Thornton

NEIL THORNTON
Principal Private Secretary

INNER GERMAN TRADE (IGT)

THE SYSTEM

1. The principal feature of IGT is that goods on a list comprising most industrial categories may be traded between the Federal Republic and the GDR free of import duty and other restrictions. (The Federal Republic maintains some quotas on categories of steel, textile, ceramic and agricultural products). Payment for these goods is effected in units of account (equal in value to the West German Mark) held in a closed arrangement between the two central banks. GDR credits at the Federal Bank are not convertible into western currencies and may only be used for purchases in the Federal Republic. The GDR therefore cannot earn foreign exchange from Inner German Trade and is under pressing economic need to increase its direct exports to other Community and Western countries.

COMPOSITION OF IGT

2. The level of trade between the two Germany's has been fairly static since 1982 at around DM6 or 7 billion in each direction. The structure of Inner German Trade has shown a preponderance of raw materials and semi-finished products; the GDR's exports of capital goods have declined in importance since the 1960s and the Federal Republic's exports have also comprised mainly raw materials and semis until the last few years, when the drop in the GDR's purchases of petroleum products produced a rise in the proportion of capital goods.

CONTROLS

3. Industry in the UK and other Member States has nevertheless expressed concern about leakage of these goods into the rest of the Community, circumventing the Common External Tariff, and in addition that some of these goods may not originate in the GDR. The Federal Republic's response is that only a very small proportion (less than 1% i.e. DM 60 million) of goods imported from the GDR is re-exported into the Community and that their Customs carry out checking procedures to ensure as far as possible that the origin rules of IGT are properly observed.

4. The controls take the following form. To confirm origin, the Federal customs carry out detailed checks at the Inner German border including, if necessary, a physical inspection of cargo. Once the goods are in the FRG, companies participating in IGT are monitored to ensure that the system of VAT credits for which importers are eligible functions properly (although the Federal authorities admit that the present arrangement for recovering VAT on re-exported goods is unsatisfactory and should be tightened up). The companies involved all have to register with the Federal authorities.



Although there are 7,000 firms involved, some 80% of trade is in the hands of just 300 companies.

SAFEGUARDS

5. The Federal Republic considers IGT imports to be in free circulation within the Community and the Commission has supported this view. Re-exported goods are not automatically subject to import duty in other Member States (unlike goods imported direct from the GDR). However, under the EC Treaty's Protocol on Inner German Trade, Member States are able to take safeguard action against GDR goods entering their territory via the Federal Republic. France and Benelux have done so. This action could extend from say, surveillance licensing through duty reimposition to the prohibition of imports, but a recent European Court of Justice ruling established that the measures adopted by a Member State must be in proportion to the threat of economic injury.

THE FUTURE

6. The Federal Republic is sensitive to the need to address other Member States' concerns about the policing of the system, and DTI and FCO officials had talks on 18 April with Bonn on current administrative procedures and how these may be adapted in the light of the Single Market. The German side explained their procedures very fully and offered to investigate any specific complaints we raised.

7. The Commission would resist any strengthening of the Community's internal frontier controls against IGT goods but would support increased monitoring by Customs at the Inner German border. The concerns of UK industry would, however, be better addressed if the Federal authorities were to impose full EC duties on IGT goods re-exported to other Member States. This idea was first mooted by the Economics Ministry to us in April, although the Commission's view of it is not yet clear. We intend to examine in a further meeting with the Economics Ministry whether the present climate of change is affecting their thinking on issues arising from the operation of IGT.