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"EUROPE 1992": ENSURING A FAIR DEAL FOR THE U.S.

INTRODUCTION

American policy makers focus considerable attention on trade with Asian countries — especially with Japan. Yet United States trade with the twelve countries of the European Economic Community (EEC),[1] which has a combined gross national product second only to the U.S., actually exceeds its trade with either Canada or Japan. Moreover, some 40 percent of U.S. overseas investment is located in the EEC, while European investment in the U.S. is substantial and growing fast.

Fundamental changes now taking place in Europe will have a major impact on Europe's economic relationships with the U.S. By the end of 1992, the EEC countries are scheduled to remove the remaining barriers to each other's trade, investment, and movement of labor, creating a true common market of 320 million people. Discrimination against other EEC countries in procurement policies by European governments is to be abolished, and the structure of value-added taxes — a form of sales tax used by EEC countries — is to be standardized.

U.S. Fears. There is concern in the U.S. that this liberalization of trade between EEC countries will be accompanied by higher protectionist trade barriers against the goods and services from countries outside the EEC. Another fear is that as a European trade bloc emerges, competing blocs of trading nations also will emerge, undermining the efforts of the General Agreement on Tariffs and Trade (GATT) to maintain and improve a global trading system.

Many U.S. firms, however, recognize that a reduction in trade barriers within the EEC could lead to a rise in European incomes and thus enormous

1 Belgium, Denmark, France, the Federal Republic of Germany (West Germany), Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

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opportunities for U.S. sales to Europe and operations in Europe. Many U.S. businesses with subsidiaries or branches in the EEC thus are expanding to be ready for 1992; others are planning to establish operations there without delay.

Assuring Economic Gains. The U.S. needs to prepare carefully for Europe after 1992 to avoid the danger of protectionism by the EEC while taking steps to assure the potential economic gains for both Europeans and Americans. In particular the Bush Administration should:

♦ ♦ Take full advantage of the leverage offered by the Uruguay Round of GATT negotiations to persuade the EEC not to create an economic "fortress Europe" by erecting trade barriers.

♦ ♦ Continue efforts in the GATT to reduce existing European agricultural subsidies and barriers to agricultural imports.

♦ ♦ Press for American companies to be allowed to review and comment upon proposed EEC directives to standardize products.

♦ ♦ Negotiate free trade areas (FTAs) with non-European countries, such as Japan, the Republic of China on Taiwan, Singapore, and Thailand. Such arrangements are desirable in themselves, but also would strengthen the bargaining position of the U.S. with the EEC.

♦ ♦ Meet the inevitable European demands for trade reciprocity in fields such as banking, steel, and textiles by preparing plans to lower U.S. trade barriers.

♦ ♦ Continue to encourage EEC countries to reverse their policies of high taxes and heavy regulation that have led to high unemployment and slow economic growth.

♦ ♦ Remove the U.S. federal government's suffocating restrictions on American banks so that they can compete more effectively with European banks.

THE IMPORTANCE OF THE U.S.-EEC ECONOMIC RELATIONSHIP

American policy makers in recent years have focused mainly on trade problems and opportunities with Asia. The U.S. government, for example, has sought to open further to U.S. exports the markets of Japan, South Korea, and the Republic of China on Taiwan. There is even talk of free trade area (FTA) agreements between the U.S. and some Asian countries, such as Japan, the Republic of China, Singapore, and Hong Kong.

One-Fifth of World Trade. This emphasis on Asia obscures the fact that Europe is a key area of U.S. economic interests. Europe is a massive trading power. The dozen EEC countries account for 20 percent of total world trade; the U.S. accounts for about 14 percent. EEC countries purchased nearly 25 percent of total U.S. exports in 1987 – slightly more than the amount purchased by Canada and more than twice as much as by Japan.

The EEC is America's biggest customer. The U.S. Department of Commerce estimates that 1988 trade in goods between the U.S. and the EEC approached $160 billion, compared with $152 billion with Canada and $131 billion with Japan. Moreover, U.S. exports to the EEC in 1987 rose by 14 percent, compared with a 7 percent increase in U.S. imports from the EEC, so that while the overall U.S. trade deficit is worrying, the trade deficit with the EEC actually declined from $26.4 billion in 1986 to $24.3 billion in 1987.

Transatlantic Financial Network. European money and capital markets have become major sources of U.S. corporate investment funds, rivaling American domestic sources. In return, many European companies raise funds in the U.S. markets – each year over $200 billion of capital passes through this transatlantic financial network. Indeed, companies on both sides of the Atlantic rely on each other's national markets as a source for capital, risk diversification, debt management, and import and export financing.

Further, European countries have major direct investments in the U.S. As of 1986, Britain's direct investments in the U.S. were an estimated $134 billion, the largest amount of any country. The EEC as a whole had an estimated $397 billion invested in the U.S. or nearly half of the entire $830 billion in foreign investments in the U.S.

HOW THE EEC WAS DEVELOPED

After World War II the countries of Western Europe saw the need for closer economic and political ties to promote economic recovery, reduce the risk of a future European war, and to face the growing Soviet threat. U.S. recovery assistance under the Marshall Plan, moreover, required that the West Europeans seek economic cooperation among themselves. America understood that trade liberalization would promote economic growth. A result of this early cooperation was the 1952 European Coal and Steel Community, initially between France and Germany and later incorporated into the EEC.

These early efforts culminated in the Treaty of Rome, signed on March 25, 1957, by Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany. This established a European Economic Community – or Common Market. Today this organization, since expanded, is known as the European Community. This latter designation implies both economic and political forms of cooperation.

Free Movement of Labor, Capital. In any such common market, countries remove trade barriers, such as tariffs and quotas, between member states and establish common tariffs towards nonmember countries. This differs from a free trade area, in which member states retain control over their trade policy to non-member countries. In addition, a common market can allow the free movement of labor, capital, and other factors of production between the member countries.

The EEC has expanded since its inception. In 1973, Denmark, Britain and Ireland joined the community. But further progress toward European integration slowed dramatically in the 1970s, due to worldwide economic problems. By the early 1980s, however, progress toward a more unified market again began to accelerate. Three new members were added – Greece in 1981, Portugal and Spain in 1986.

The Brussels-based EEC Commission, the policy-making body whose members are appointed by the EEC governments, developed some 300 directives in 1985 in a document called "Completing the Internal Market." Referred to as the "White Paper," these directives, if enacted by the member governments, will harmonize technical standards for production of goods, eliminate long delays for cargo shipments at frontier crossings, remove barriers to trade within the EEC of such services as banking and transportation, and eliminate restrictions against bids for government purchases and contracts by businesses residing in a different EEC country. It is the planned enactment of the White Paper directives that will achieve full EEC economic integration by the end of 1992 – if indeed they are enacted by that time.

What the White Paper Does Not Do

The arrangement in 1992 would not eliminate every barrier to free markets and economic growth. The directives will not, for instance, remove barriers to competition from other countries. Example: import quota restrictions on automobiles, textiles, footwear and electronics will remain. The White Paper also is virtually silent on steps to introduce non-EEC foreign competition into government procurement – which accounts for about 15 percent of the EEC's gross national product. Only 2 percent of procurement by EEC governments currently is produced by foreign companies.

There is little indication, moreover, that the EEC intends to abolish internal government subsidies to agriculture, fisheries, steel, and textiles. The EEC's notorious Common Agricultural Policy has created "mountains" of butter and "lakes" of wine at the expense of European taxpayers and consumers. Further, such crucial sectors as energy, some modes of transportation, water supplies, and telecommunications have been exempted from broad 1992 reforms.

Also not addressed in the plan for 1992 are economic and industrial policies that have contributed to relatively slow growth and job creation in Europe. Example: high unemployment benefits and social insurance taxes that discourage employment; rigid curbs on plant closings and layoffs, which discourage entrepreneurs. Similarly, the White Paper contains no plans for a substantial reduction in government ownership of industries, which usually are a drag on the economy – although some member countries, most notably Britain, are "privatizing" state-owned corporations.

Obstacles to Integration

It is possible that the EEC countries will not meet their 1992 goal of integration. The difficulties for the twelve member governments each to enact the numerous pieces of legislation to adopt the 300 White Paper directives are monumental.

Aside from inadequacies of the White Paper, other factors pose potential obstacles to the goal of integration. Groups with a vested interest in the EEC countries' regional economic differences, for example, will create barriers to full integration in 1992. Thus because low wages in Spain and Portugal can be expected to attract firms from high-cost countries such as Germany, unions in high-wage member countries can be expected to resist integration. Similarly, there are concerns among airlines in some countries that such aggressive and efficient carriers as British Airways and Lufthansa will take business from the less efficient national carriers. Similarly, differences in the strength, regulation, and practices in insurance, banking and other financial firms inhibit European efficiency, but they will tend to be guarded by countries fearing competition from other EEC members.

Breaking Down VAT Frontiers. Differences in tax structure also will be a barrier to integration. Each EEC country has a value-added tax (VAT). But these rates vary considerably between countries. The EEC Commission believes that internal economic frontiers in Europe cannot be eradicated without a more uniform VAT rate. But VAT equalization would displease both the high VAT countries – such as Denmark and France, which would lose income – and low tax countries – such as Britain, which would lose their competitive advantage when they raised their rates.

Fear of a loss of political sovereignty also raises concerns among some European leaders. This tension has erupted in recent months with exchanges between the President of the EEC Commission, Jacques Delors, and Britain's Prime Minister Margaret Thatcher. Delors, a French citizen, provoked an angry exchange last year with the forecast that within ten years "80 percent of economic legislation and perhaps tax and social legislation" for member countries will be decided in Brussels, where the EEC bureaucracy is located. Thatcher retorted angrily that she has not worked to deregulate and boost the British economy with conservative policies only to have her efforts undone by socialist bureaucrats in Brussels.

The Issue of Monetary Union

Fluctuations in the exchange rates of the currencies of different countries can make international trade and business transactions difficult. Further, countries often manipulate their exchange rates for domestic economic reasons, for example, keeping their currencies undervalued to promote exports.

The European Monetary System, formed in 1979, is a means by which most of the EEC members attempt to regulate the value of their currencies

relative to one another. This has helped moderate exchange rate fluctuations between member countries.

Europe's leaders generally agree that stable currencies and free capital flows are crucial to an integrated EEC in 1992. EEC President Delors points to two goals for the European Monetary System – or EMS. One is to persuade Britain, which is reluctant to allow its monetary policy to be set by Brussels, to join the EMS. The second is to convince West Germany to accept the idea that exchange rate policy should be geared toward creating prosperity as much as toward monetary stability. Delors favors using monetary policy to promote economic growth. The West Germans, on the other hand, with Europe's strongest currency, prefer slow monetary growth and low inflation even if this means high unemployment and slower economic growth.

If Delors' goals are reached, a strengthened EMS would regulate the value of European currencies in international foreign exchange markets, operating much like the U.S. Federal Reserve Board. Strong supporters of monetary union ultimately wish to see a common EEC currency replacing existing national currencies.

HOW EUROPEAN BUSINESS VIEWS 1992

The prospect of 1992 has affected corporate decision making in EEC countries significantly. European firms are modernizing, feeling that the changes scheduled for 1992 will enable them to compete against major American and Japanese firms. European companies are in a frenzy of mergers, acquisitions, and joint ventures in readiness for 1992.

Unilever N.V., the foods, detergent, and soap multinational, is pursuing a new strategy for a truly unified Europe. The Dutch electronics multinational, Philips Industries N.V., has reorganized its consumer organization by replacing its 60-year-old policy of national companies with a Europe-wide, product-based organization. A number of medium size companies in the same business in different countries, moreover, are forming joint ventures to attain a combined size sufficient to compete.

It appears that local European securities exchanges will become less important as more large transactions are handled off market by transnational brokerage firms in a trans-European over-the-counter market.

WILL 1992 MEAN PROTECTIONISM BY THE EEC?

Many Europeans argue that they and the rest of the world face economic domination by America and Japan unless Europeans stick together. Indicative of this mood in Europe was a 1987 television commercial, sponsored by the French government, showing a skinny French boxer squaring off in a one-sided, evidently unfair, battle with a giant American football player and an equally menacing Japanese sumo wrestler. Eventually,

eleven other boxers, representing the EEC countries, rushed to the boxer's rescue and the "bullies" turned away.

Crude though such a commercial may seem to Americans and their lawmakers, it captures the tone of Europe and explains a major part of the impetus for European economic integration. On one level, Europe's politicians and businessmen proclaim the benefits that will flow from the single EEC market in 1992. But on another level, businessmen, politicians and bureaucrats see a unified Europe as a way of "getting tough" with exporters from the rest of the world through Europe-wide protectionism.

Protectionist Pressure. Many European policy makers invoke the buzz words of protectionists in the U.S. – "reciprocity," "level playing field," and "fair trade." In light of the trade restrictions enacted by the U.S. in recent years, and still threatened by Congress, it is likely that the pressure for protectionist reciprocity will grow in Europe as 1992 nears. Though Sir Roy Denman of Britain, the EEC representative to the U.S., says there is nothing to worry about, many Americans rightly remain concerned.

Actions by the EEC have done little to quell U.S. fears. Last year, for instance, the EEC imposed anti-dumping duties on such Japanese products as typewriters assembled in Taiwan. Further, the American subsidiary of Japan's Ricoh Co., Ltd. is the subject of a case in an EEC customs advisory committee. The EEC will decide on whether to accept a U.S. certificate of origin granted to California-made Ricoh photocopiers. When the EEC imposed a 20 percent anti-dumping duty on Ricoh copiers imported directly from Japan, production at Ricoh's Irvine, California, plant was doubled to 4,000 copiers per month, many of which were shipped to the EEC. The EEC has no firm rules to determine whether the percentage of Japanese-made parts is "too high" for the assembled product to be considered of U.S. origin. The EEC committee's decision is awaited with keen interest by American and Japanese authorities and companies.

Restricting U.S. Firms. The standardization of EEC product specifications could be another obstacle to the entry of the U.S. products into the EEC market after 1992 – despite the general assumption that they will make marketing in Europe much simpler for U.S. firms. The EEC harmonization directives for such standards easily could be framed to limit American manufacturers' ability to meet the EEC specifications. This would restrict the ability of U.S. firms to sell in the huge EEC market. U.S. companies will not be given the opportunity to review and comment on proposed EEC standards and directives during this crucial development phase. And when directives are published in final form, usually there is little chance for changes.

Further, an EEC policy of trade "reciprocity" would mean that a country seeking to sell in the EEC would be a subject to the same restrictions that the country maintains against EEC products coming into its market. This is the "mirror" approach to trade rules. Sometimes reciprocity involves a "market-share" or "managed trade" policy, in which one country guarantees a certain percentage of its market to another country in return for a percentage of its market.

Such mirror legislation by the EEC could be especially harmful to U.S. banking. For example, it would lead to demands for EEC-based banks to have the right to operate in the U.S. across state lines – a right not fully accorded American banks. Failure by the U.S. to guarantee this for European banks could lead to tight limits on the right of U.S. banks to conduct business across EEC borders, while European banks and institutions from most other countries would be free to compete. One positive sign is that the EEC Commission has decided so far not to seek retroactive reciprocity on foreign banks already inside the Community. The opportunities for new U.S. bank ventures in Europe, however, are questionable.

THE DANGER OF NATION TRADING BLOCS

Some policy makers fear that EEC integration could prompt protectionist trade blocs. In the 1930s, triggered by America's protectionist Smoot-Hawley Act of 1930, the British, French and Japanese each attempted to monopolize trade with their colonies. The economic problems and cost of this caused, to considerable extent, the Great Depression.

Recently, the U.S. and Canada signed a free trade area (FTA) agreement, by which both countries will eliminate tariffs and many non-tariff barriers to one another's goods. A number of other countries are seeking FTAs with the U.S. Even Japan has expressed interest. There is fear that if the EEC organization turns protectionist in 1992 and that if the U.S. proceeds with new FTAs, destructive trade blocs again could emerge.

FTA Benefits. Yet, there are major differences between the incentives established by trade blocs and those set up by FTAs. With an FTA, each country retains control of its own imports from nonmember nations. Therefore, if one FTA country erects new trade barriers against a nonmember country, the other FTA partner need not follow suit. Since it is not likely that both FTA partners will perceive benefits to be gained from the same sorts of trade restrictions, FTA members are unlikely to erect the same trade barriers to non-members. Thus FTAs probably will not touch off a trade war between the U.S. and the EEC.

U.S. FTAs with non-EEC countries would put EEC enterprises attempting to export to the FTA markets at a disadvantage. They would face trade restrictions that the member countries had eliminated in the FTA. All countries involved would suffer if new trade barriers were erected. All would benefit from negotiations that lead to, or at least approach, free trade.

If the EEC follows a protectionist trade policy, the greatest danger to the U.S. probably will be an economically weak Europe. Gains in EEC economic efficiency and output could be offset in the long run by the adverse effects on its economy of trade protection. Combined with the high taxes and overregulation now typical of almost all EEC countries, this could cause economic stagnation. The EEC would be less able to purchase U.S. goods and services due to its protectionism and resulting lower incomes.

1992 AND THE GATT

The EEC's preparations for 1992 coincide with the Uruguay Round of trade liberalization negotiations within the GATT. While EEC officials say that the two sets of trade changes will be complementary, they also reluctantly admit that some defensive import mechanisms likely will be retained by the EEC. France, Greece, Italy, Portugal, and Spain are particularly concerned that integration in 1992 will benefit outsiders as much or more than EEC companies. One goal of the GATT round is to stop the spread of "orderly marketing agreements" or "voluntary restraint agreements." Under such arrangements, governments establish quota restrictions on imports of specific products from other countries. One example is the U.S. agreement with Japan regarding auto imports. Under pressure from some EEC members, there is a serious danger that existing restrictions by individual European countries against outside goods will be replaced by continent-wide EEC restrictions.

GATT and EEC objectives could conflict in another politically sensitive area – agriculture. A major aim of U.S. GATT negotiators is to eliminate all subsidies and trade barriers for agricultural products. Reflecting pressure from European farmers, the EEC strongly opposes this move. In fact, special EEC agricultural restrictions against nonmember countries were erected last year to help Spain and Portugal adjust to EEC membership.

HOW THE U.S. GOVERNMENT SHOULD PLAN FOR 1992.

U.S. reaction to the economic integration of Western Europe in 1992 should be planned carefully and should take account of the actions and policy changes of the EEC as it nears its goal. The U.S. aim should be to prevent trade protectionism and to help both Americans and Europeans to enjoy the benefits of open trade. The U.S. should:

1) Use the Uruguay GATT round to counter EEC protectionist policies.

It is fortunate that EEC integration coincides with the new GATT round. This allows the U.S. and other non-EEC members to press EEC countries not to raise new trade barriers to "protect" their newly integrated market. With skillful negotiating by the U.S. and other non-EEC countries, the GATT could be used to push European countries to agree that the EEC after 1992 will be more accessible to products and services from overseas. Further, the EEC's Common Agricultural Policy should be a target for U.S. negotiators at the Uruguay Round. But to be effective, U.S. officials must be prepared to permit market forces also to operate fully within the U.S.

2) Agree to remove U.S. trade barriers, in exchange for EEC concessions and to avoid reciprocal protectionist action by the EEC.

The U.S. has erected more new trade barriers over the last six years than either the EEC or Japan. Among these: quotas on steel, computer chips, and automobiles. The Trade and Competitiveness Act of 1988, while not as

restrictive as earlier versions considered by Congress, does provide additional opportunities for U.S. businesses to gain protection from imports. In addition, the share of manufactured imports into the U.S. subject to nontariff barriers rose from 9 percent to 15 percent between 1981 and 1986 while the EEC rise was from 10 to 13 percent. The U.S. must be prepared to bargain away some of its protectionism to gain access to the European market and to defuse pressures for similar protectionism in Europe.

3) Press for American companies to be allowed to review and comment upon proposed EEC directives to standardize products.

If product specifications are finalized without testimony from U.S. companies, American business could find itself at a serious disadvantage competing in the integrated EEC market. The Bush Administration should monitor this situation and insist that U.S. firms be allowed access to the process by which these regulations are formulated.

4) Deregulate U.S. banking to avoid reciprocal business restrictions against American banks from the EEC and to make American banks more competitive.

The federal government does not permit banks, whether American or foreign to operate freely across state lines. This restriction could lead to similar restrictions on American banks operating in an integrated EEC. Further, the federal government prohibits American banks from offering both commercial lending and financial services through the same institution. This puts U.S. banks at a special disadvantage when competing with European banks, which face no such restrictions. Congress and the Bush Administration should remove these restrictions so American banks can compete with their European counterparts after 1992.

5) Urge the Europeans to follow growth-oriented economic policies.

There is a danger that the EEC will continue to follow the policies of high taxes, strict economic regulations, and trade protectionism of most of its member countries. If that occurs, Europe's economy will suffer even higher unemployment and stagnation than it has in the 1980s. A fully integrated EEC that adopts the worst economic policies of its members will ensure EEC-wide economic stagnation. This not only would be bad for Europeans, it would rob the U.S. of potential customers for its goods. The U.S. thus should continue to urge the EEC to link integration with moves to cut taxes and deregulate economic activity.

6) Negotiate Free Trade Area Agreements with non-EEC countries to create incentives for the Europeans to keep their markets opened.

If the U.S. opens markets for itself with other countries, especially in dynamic Asia, through the use of FTAs, the EEC would find it more difficult to compete in FTA countries. Greater EEC trade protectionism would not eliminate this problem. Rather, the EEC would have an incentive to seek freer trade with the U.S. and its FTA partners.

CONCLUSION

EEC 1992 will not see a United States of Europe. There are too many obstacles, cultural and institutional as well as economic, to overcome in too short a period. Indeed, there are doubts whether the EEC will reach even its limited goal of integration by 1992.

Closer, More Open Europe. However, the EEC in 1992 will be a different, more cohesive place, and probably will be on the path toward closer union and a more open internal market. As the EEC moves toward this, Washington must bargain for U.S.-based companies to be permitted to function in the immense, rich EEC 1992 market.

The growth of U.S. trade protectionism and a protectionist EEC could endanger international economic growth as protectionism did in the Great Depression of the 1930s. Yet the U.S. should use European integration as an opportunity to promote further trade liberalization. The removal of trade barriers, whether between the EEC countries themselves or between the U.S. and its free trade area partner, Canada, benefits all countries involved.

Common Goals. The desire for higher economic productivity, more consumer choice, lower prices, and greater access to foreign markets in part has motivated Europe to seek integration and the U.S. to seek FTAs. If the U.S. and the EEC approach one another in this spirit, their interests need not conflict, but will allow both to achieve these goals through mutual trade liberalization.

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