The Heritage Foundation Backgrounder

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A SEVEN-POINT U.S. STRATEGY TO PUSH EUROPE TO FREE TRADE

INTRODUCTION

While Europe's political upheavals grab the headlines, the continent is undergoing an equally fundamental, if less dramatic, economic transformation. From the fading familiar divisions of post-World War II Europe may emerge a single continental economy with over 600 million people. The stakes for America in this quiet revolution are high. America's prosperity will be advanced by the emergence of a Europe with markets open to the world and with economies fully integrated into the West. By contrast, an insular, protectionist Europe could become a drag on the American economy. As such, the most effective way for America to advance its economic interests in Europe is through a strategy to move Europe inexorably toward free trade.

No region of Europe is unaffected by the sweeping economic changes now underway. In Eastern Europe, countries newly freed from Soviet domination are dismantling Stalinist command economies and moving toward free market economies.[1] Further east, several of the European republics of the Soviet Union

1 The term "Eastern Europe" has been used since World War II to denote that area of Europe under Soviet control. Historically, however, the northern portion of that bloc – Czechoslovakia, East Germany, Hungary, and Poland – has been known as "Central Europe," a term which recently has returned to common use in those countries. Geographically, the European republics of the Soviet Union constitute the actual "Eastern" Europe.

have begun introducing free market reforms and are moving toward independence. And in Western Europe, the twelve-member European Economic Community (EC or Common Market) is in the final stages of eliminating many of the barriers to trade among its members.[2] Dubbed "EC '92," this project is on track to create a single market of 340 million, the world's largest, by the end of next year. Meanwhile, negotiations are underway between the EC and the European Free Trade Association (EFTA), a group of developed European countries outside the Common Market, aimed at creating a new sphere of economic cooperation, to be known as the European Economic Area (EEA).[3]

U.S. Interests. America has a tremendous stake in the outcome of Europe's economic revolutions. First among America's interests is to ensure non-discriminatory access for itself to European markets. U.S. trade with the EC alone amounted to $190 billion in 1990, exceeding trade with Canada or Japan and accounting for one-quarter of total U.S. trade. A second interest is preventing EC protectionism from undermining progress in the liberalization of world trade.

A third U.S. interest is ensuring that the countries of Eastern Europe and the European republics of the Soviet Union make the transition to free market economies. This not only would expand markets for American goods and services, but would advance America's strategic interest in stabilizing the new democratic governments in Eastern Europe and integrating these states into the West.

All these objectives can be advanced through the promotion of free trade, which ensures access to markets, stimulates economic growth, and steadily increases the ties among countries.

But there is a cloud darkening this horizon. The EC increasingly is emerging as a major impediment to free trade. During the most recent round of negotiations of the General Agreement on Tariffs and Trade (GATT), the organization largely responsible for the post-World War II liberalization of global trade, talks broke down over the EC's refusal to reform its heavily subsidized agricultural sector.[4]

Protectionist Path. Even worse, the EC threatens to push the rest of Europe, including the newly liberated countries of Eastern Europe, down the protectionist path. This would damage America considerably. Instead of dealing with a prosperous and dynamic continent from the Atlantic to the Urals, in which barriers to trade had been largely eliminated, America might find itself dealing with a

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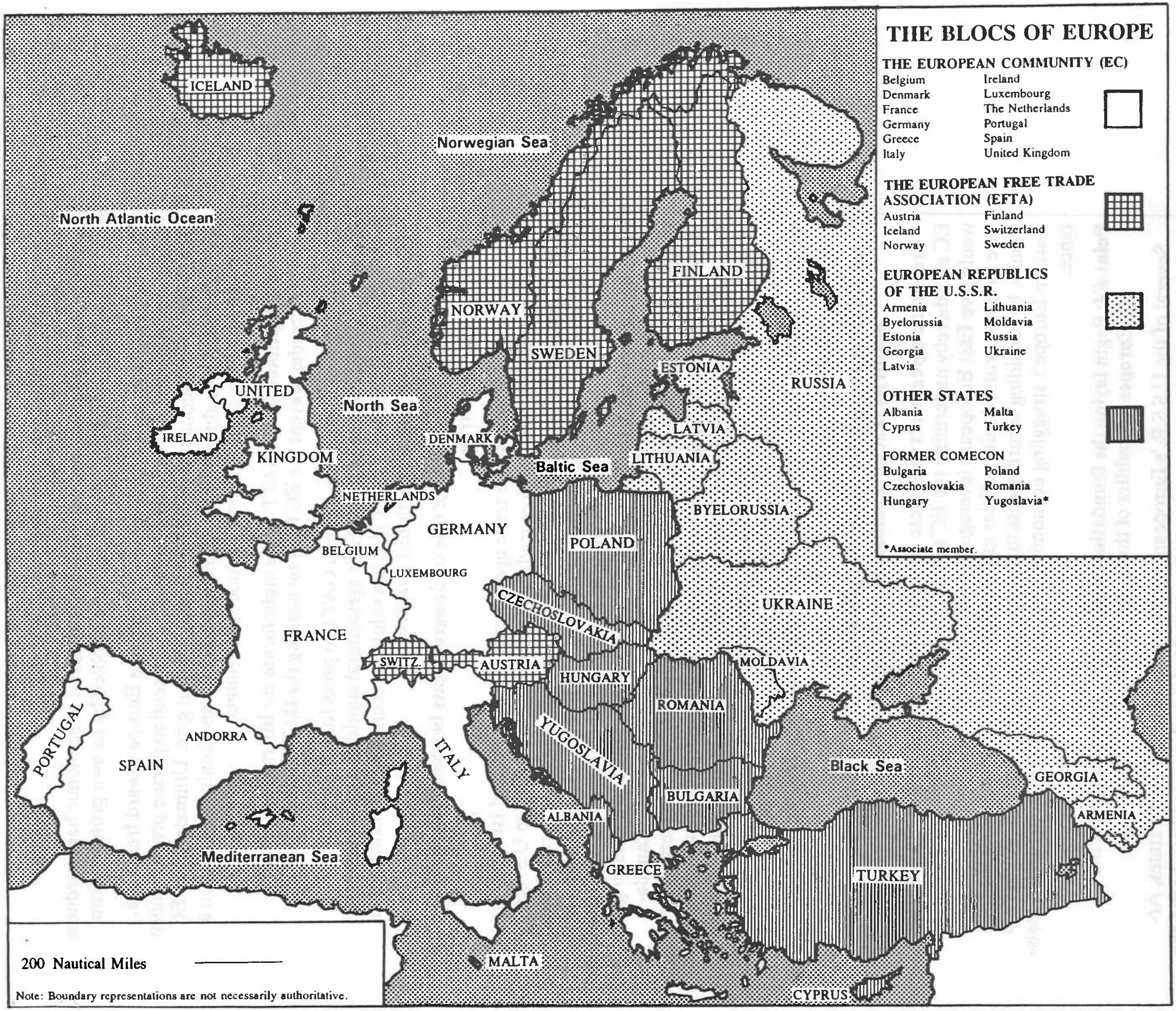
2 Properly, "EC" is an abbreviation for "European Communities," not the widely used but inaccurate term "European Community." The EC is composed of three different organizations: the European Economic Community (popularly referred to as the Common Market), the European Coal and Steel Community, and the European Atomic Energy Community. The EC's members are Belgium, Britain, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Spain, and Portugal.

3 EFTA consists of Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

4 The General Agreement on Tariffs and Trade (GATT) was established in 1948 to promote trade liberalization. Through several "rounds" of negotiations, it has reduced significantly tariffs and other barriers to trade and has produced an enormous increase in global trade. The latest round was suspended last December over disagreement between the EC and most other countries regarding agricultural subsidies.


THE BLOCS OF EUROPE
THE EUROPEAN COMMUNITY (EC)
Belgium
Denmark
France
Germany
Greece
Italy
Ireland
Luxembourg
The Netherlands
Portugal
Spain
United Kingdom
THE EUROPEAN FREE TRADE ASSOCIATION (EFTA)
Austria
Iceland
Norway
Finland
Switzerland
Sweden
EUROPEAN REPUBLICS OF THE U.S.S.R.
Armenia
Byelorussia
Estonia
Georgia
Latvia
Lithuania
Moldavia
Russia
Ukraine
OTHER STATES
Albania
Cyprus
Malta
Turkey
FORMER COMECON
Bulgaria
Czechoslovakia
Hungary
Poland
Romania
Yugoslavia*
*Associate member.
ICELAND
Norwegian Sea
North Atlantic Ocean
NORWAY
SWEDEN
FINLAND
ESTONIA
RUSSIA
UNITED KINGDOM
IRELAND
North Sea
DENMARK
Baltic Sea
LATVIA
LITHUANIA
NETHERLANDS
GERMANY
BYELORUSSIA
BELGIUM
LUXEMBOURG
POLAND
CZECHOSLOVAKIA
UKRAINE
FRANCE
SWITZ.
AUSTRIA
HUNGARY
MOLDAVIA
ROMANIA
PORTUGAL
SPAIN
ANDORRA
ITALY
YUGOSLAVIA
Black Sea
GEORGIA
BULGARIA
ALBANIA
ARMENIA
Mediterranean Sea
GREECE
TURKEY
200 Nautical Miles
Note: Boundary representations are not necessarily authoritative.
MALTA
CYPRUS

Europe divided and slow-growing, with the East mired in economic backwardness and beset by political instability, and the West hobbled by its own protectionism.

To prevent this, America needs a strategy to move Europe toward free trade. Pressure must be brought on European leaders who tend to pursue protectionism out of misguided nationalism or for short-term political gain. Ultimately, the EC must be pressed into abandoning protectionist policies and joining America in a free trade area. This strategy should include seven points:

Point #1: Continue to use GATT as the main forum for liberalizing global trade; prevent the EC from torpedoing the GATT negotiations.

Washington should continue through GATT to press for additional trade liberalization and for an end to the EC's agricultural subsidies and trade restrictions in farm commodities. GATT also is a valuable forum for mobilizing global pressure against the EC's protectionist policies.

Point #2: Expand the number of free trade agreements between America and other countries.

At present America has free trade agreements with Canada and Israel and is negotiating one with Mexico. Free trade agreements open markets to U.S. businesses. They also deliver a useful message to the Europeans that America has the option of establishing a separate free trade system of its own if European protectionism continues to block further trade liberalization. The emerging U.S.-Canada-Mexico free trade area, for example, would have more people and a greater gross national product than the EC. Once established, moreover, the U.S.-Canada-Mexico free trade area could be expanded throughout the Western Hemisphere. Chile already is pressing for such an agreement. American free trade agreements with countries in East Asia would be particularly valuable. In addition to expanding U.S. business opportunities, these agreements would create the specter of a North American-East Asian trading bloc capable of coordinating policies against the EC. The EC could not afford to be left out of what would be the world's largest trading group.

Point #3: Offer to negotiate free trade agreements with East European countries that have embarked on free market reforms.

Free trade agreements with these countries would open a "back door" into the EC and thereby undermine the EC's ability to maintain its trade barriers. It also would give East Europeans leverage to resist what might be mounting EC pressure to adopt protectionist policies as the price for better relations with the EC. Finally, by providing secure access to the American market, the U.S. would help Eastern Europe's struggling economies far more than by giving them foreign assistance.

Point #4: Begin laying the foundation for free trade agreements with the European republics of the Soviet Union.

Several of the U.S.S.R.'s European republics, including the Baltic states, Armenia, and Georgia, are moving rapidly toward independence and have begun the transition to a free market economy. Eventually, the giant Russian republic could join them. America should hold out the prospect of free trade agreements with these republics. For one thing, this would be an incentive for them to complete their economic and political reforms quickly. For another, it would pressure the EC to move to free trade. And, of course, adherence to the conditions required to compete and survive in a free trade environment – such as property rights, mobility of labor and capital, and elimination of barriers to foreign investment – would ensure the permanent disappearance of authoritarian regimes. The potentially huge markets of the U.S.S.R.'s European republics could be opened to U.S. business, and their devastated economies best assisted, by eventually including them in a free trade area with the U.S.

Point #5: Complete the EC's encirclement by offering to negotiate free trade agreements with other non-EC European countries, particularly Turkey.

Several European countries either do not wish to join the EC or have been rejected by it. These include not only EFTA members like Iceland and Switzerland, but also Turkey. Many EFTA members are uncomfortable being drawn into a closer embrace by the EC, but see no other option. Closer ties with America would help these countries resist the EC's influence and further would pry open the "back door" into EC markets.

Point #6: Split the EC.

The Bush Administration should work with Britain, The Netherlands, and any other EC country that favors greater free trade to prevent the EC from adopting additional protectionist practices. Discussions with these and other governments should focus on how best to coordinate policies to halt additional EC protectionism.

Point #7: Ultimately, propose an America-EC Free Trade Agreement.

Once the EC is surrounded by a U.S.-led free trade area and its options reduced, the logic and advantages of free trade finally may become apparent to the EC leadership. The culmination of U.S. strategy would be a broad free trade agreement between the U.S. and the EC as a whole.

EUROPE'S UNCERTAIN PATH TOWARD FREE TRADE

As the dominant world power after World War II, America assumed principal responsibility for reconstructing the war-ravaged economies of Western Europe and rescuing the international economic system. American leadership helped liberalize and expand global trade. In Western Europe, America erected an entirely new economic order. Such historical enemies as France and Germany were persuaded to work together economically and to drop barriers to trade and commerce among themselves.

This soon took organizational form: the European Coal and Steel Community (ECSC) was created in 1952, consisting of Belgium, France, West Germany, Italy, Luxembourg, and The Netherlands. Although formally an organization for economic cooperation, its underlying rationale was a belief that integration of the key economic sectors of coal and steel would make war between member countries impossible. A direct outgrowth of the ECSC was the European Economic Community (EEC), formed in 1957.

As its nickname "the Common Market" suggests, the EEC was established to promote the creation of a single integrated market among its six member states' economies. It was combined with the ECSC, and the European Atomic Energy Community (Euratom), to form the European Communities (EC). The EC gradually was expanded from its original six members to the present twelve, adding Britain, Ireland, and Denmark in 1973, Greece in 1981, and Spain and Portugal in 1986.

In 1960, several European countries that did not wish to join the EC, or whose memberships had been rejected, banded together to form the European Free Trade Association (EFTA). Founded to promote free trade among its members, EFTA differed from the EC in that it did not aim at economic or political integration. EFTA originally included Britain, Denmark, and Portugal; they later left to join the EC.

Divergent Economic Paths. As Western Europe moved toward free markets and integration into the global economy, Eastern Europe fell increasingly under Soviet domination and became tied almost exclusively into an insular East bloc trading system. In the years after World War II, Moscow imposed Soviet-style central planning on East European economies, virtually wiping out private enterprise. While America pumped over $12 billion into Western Europe under the Marshall Plan (approximately $70 billion in 1991 dollars), the Soviet Union extracted roughly the same amount from its East European satellites. The Council for Mutual Economic Assistance (Comecon) was created by the Soviet Union in 1949 to increase its control over East European economies, which effectively became extensions of the Soviet economy. Comecon's original members were Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and the Soviet Union. Later additions were Albania (admitted in 1949, but withdrew in 1961), East Germany (1950), and Yugoslavia (1964).[5] Trade was conducted primarily by barter.

Europe hence developed along two divergent economic paths: an increasingly prosperous Western Europe that was part of a global trading system, and an Eastern Europe cut off from its Western neighbors and falling increasingly behind the industrialized world in income, technological development, and competitiveness.

This post-World War II order lasted for over four decades, but largely has been destroyed by two major developments: Eastern Europe's anti-communist revolutions of 1989 and Western Europe's movement toward political and economic union.

5 Non-European members included Cuba (1972), Mongolia (1962), and Vietnam (1978).

THE EAST EUROPEAN REVOLUTIONS

In 1989, the East Europeans threw off Soviet control, and the region's communist regimes collapsed. Although communist holdovers cling to power in Albania, Romania, and the Yugoslav republic of Serbia, most of Eastern Europe is on a firm path to democracy and free markets.

The economic problems facing Eastern Europe's new governments are staggering. The entire region shares a depressing economic legacy of Soviet rule: grossly antiquated industrial plants and infrastructure; Third World living and health standards; excessive emphasis on steel and other heavy industries; primitive service sector; high energy consumption; ecological devastation; and agricultural inefficiency.

With this legacy, the need for rapid conversion to free markets is widely accepted in these countries despite the short-term economic dislocation it inevitably will cause. Poland has been the leader in this transition. Since the beginning of 1990, the Polish government has opened its economy to foreign investment, stopped subsidizing money-losing state enterprises, freed prices, and made the Polish currency convertible. Poland also is determined to privatize state enterprises. In other countries, reforms lag, particularly in Romania where state control of the economy has eased only slightly.

Most Western countries have created assistance programs for Eastern Europe; the Bush Administration has requested $470 million in aid for Eastern Europe for fiscal 1992. In addition, such institutions as the European Bank for Reconstruction and Development (EBRD) have been established by Western governments to give grants and loans to the private and public sectors in Eastern Europe. The EBRD, which officially began operations in April 1991, is to be capitalized at $12 billion, making it the major lending institution to Eastern Europe.[6]

Generous Aid. For all their generosity, Western aid programs for Eastern Europe cannot lift Eastern Europe out of its economic quagmire. For this, fundamental reform is needed. In fact, there is a danger that Western aid programs may slow needed reforms by reducing the economic pressure on East European governments to take such basic, but often politically unpopular, measures as freeing prices.

Instead of receiving aid, these countries would be better served by increased access to Western markets and hence the opportunity to earn their own hard currency. Yet even as they offer aid, Western countries – in particular the EC – continue to maintain barriers to the import of products from Eastern Europe in agricultural goods and textiles, where Eastern Europe is most competitive.

6 The EBRD made its first loan in June 1991, providing $50 million to Poland for energy conservation projects.

The big unanswered question regarding the future of Eastern Europe is whether the revolutions of 1989 will be repeated across the border in the European republics of the Soviet Union.[7] They may well be. The political authority of the Soviet regime continues to decline while that of the democratic opposition gathers strength, especially in the European republics. In Armenia, Estonia, Georgia, Latvia, Lithuania, and Moldavia, democratic governments have been elected. These soon may be joined by Ukraine and Byelorussia. In addition to a firm commitment to independence, each of those with democratic governments is committed to establishing a free market economy. In the giant Russian republic, Soviet leader Mikhail Gorbachev's major opponent – Boris Yeltsin – has vowed to introduce free market reforms, albeit with strong opposition from the Soviet central government.

WESTERN EUROPE – A DANGER TO FREE TRADE?

Western Europe's economic transformation is as important for America as the revolutions farther east. Were EC efforts devoted as much to liberalizing trade with the rest of the world as they are to dropping trade barriers among EC members, EC consolidation and expansion would be welcome. After all, a growing European market open to American goods would be as much of a boon to America's economy as to Europe's. But the EC Commission, and many of the governments of its member states, in many ways remains devoted to protectionism, an addiction that may worsen.

The most glaring example of EC protectionism is the Common Agricultural Policy (CAP). The CAP is the EC's most elaborate bureaucratic creation to date, accounting for two-thirds of the EC's $55 billion annual budget. The CAP is designed to shield Western Europe's inefficient farm sector from foreign competition by fixing agricultural prices at above-market levels and by subsidizing farmers. These subsidies enable EC farmers to undersell America and other countries in food markets around the world. As serious, the CAP weighs heavily on the EC. Its estimated annual cost to Europe's consumers includes $49 billion in taxes to pay for direct subsidies to farmers and $85 billion in higher food prices.[8]

The EC also protects high-tech industries in a misguided effort to give them an edge over their American and Japanese competitors. Funds are being lavished on programs such as ESPRIT, which supports basic high-tech research in such areas as computers, high-definition television (HDTV), and telecommunications. With few exceptions, these programs are reserved exclusively for EC companies. With no exceptions, these programs are inefficient.

7 The European republics of the Soviet Union include Armenia, Byelorussia, Estonia, Georgia, Latvia, Lithuania, Moldavia, Russia, and Ukraine.
8 *The Economist* March 23, 1991.

U.S. WORLD TRADE 1990
$ billions

	U.S. Exports	U.S. Imports	Total
EC	98	92	190
Britain	23.5	20.3	43.8
Germany	18.8	28.2	47.0
France	13.7	13.1	26.8
EFTA	10.9	13.7	24.6
Soviet Union	3.1	1.9	5.0
COMECON	1.7	1.1	3.6
Turkey	2.3	1.2	3.5
Total Europe	116	110	227
Canada	83.9	91.4	175.3
Japan	48.6	89.7	138.3
Mexico	28.4	30.2	58.6
Total U.S.	394	495	889

Source: U.S. Department of Commerce **Heritage InfoChart**

Among EC countries, France is probably the most protectionist. With one-third of French industry owned by the state, public subsidies and favors have been distributed extensively to failing companies. Example: Over the past decade, the French government has given almost $3 billion in subsidies to its state-owned computer company, Groupe-Bull and favored it with government purchasing contracts.[9] Nevertheless, Groupe-Bull is in serious financial difficulties and is asking for still more public cash. France's new Prime Minister, Edith Cresson, is an avowed protectionist and has established a new and powerful ministry embracing finance, trade, telecommunication, and industry with a mandate to protect and promote France's international trade.

Much of Western Europe's protectionism is aimed explicitly at Japan. This has led to restrictions on the import of Japanese cars. Although Britain and a few other EC countries welcome free trade in automobiles, France has imposed a "voluntary" ceiling of 3 percent of its market for Japanese cars; Italy's restrictions are even more severe. In the name of ending these national restrictions, the EC has proposed extending protectionism throughout the Community with an EC-wide quota for Japanese cars of 11 percent of the market. This will be allowed to rise only gradually to 17 percent by 1999. By contrast, Japanese cars account for 30 percent of the U.S. market.

9 *The Economist* April 20, 1991.

Similarly, French officials have attempted to help their electronics firms by virtually forbidding the importation of Japanese electronics. Recently, when the Japanese electronics company Fujitsu, Ltd. bought the British company ICL, the latter was deemed to be no longer "European" and was ejected from JESSI, an EC-dominated, government-aided consortium that funds computer research.

Hitting America, Too. Although American firms do not face the same overt discrimination as Japanese firms – for example, the European subsidiaries of such American firms as International Business Machines Corp. are allowed to participate as European companies in JESSI and other programs – protectionist measures aimed at Japan can hit America. Example: To circumvent EC restrictions on Japanese imports, Honda Motor Co., Ltd. is proposing to ship to Europe cars made in its American plants; France wants to label these "Japanese," and subject to the quota.

An area of particular concern for the U.S. is Airbus Industrie, a consortium of aerospace companies in Britain, France, Germany, Italy and other EC countries that builds commercial aircraft. Airbus has become a major player in the world civil aviation market over the past two decades, eroding the commanding American presence. This challenge has been possible only through massive subsidies to Airbus from European governments. The U.S. Department of Commerce estimates this government support at $13.5 billion to date in direct subsidies and far larger amounts in concessionary loans. Airbus, in fact, never has made a profit in its twenty years of existence; its aircraft are sold at a price estimated to average one-third below actual costs. U.S. protests have been to no avail, and the U.S. recently referred the case to GATT for review for possible trade violations.

The problems with Airbus are not an isolated phenomenon. Although the worst fears of a "Fortress Europe" with high protectionist walls have not yet been realized, the number of American trade disputes with the EC has been growing. The experience of these disputes, ranging from banking to pasta imports to electronics, indicate the troubling EC tendency to adopt free trade practices only under pressure.

EC Intransigence. This stubbornness endangers the world trading system. EC anti-trade practices are under discussion in the current round of GATT negotiations, which is aimed at significantly lowering trade barriers around the world. After five years of negotiation and an unprecedented scope of agreement among the world's industrialized and developing nations, the talks have foundered on the EC's refusal to modify the CAP significantly. America's position has been that a GATT agreement that fails substantially to liberalize trade in agricultural products would penalize America and the many other countries that have a comparative advantage in agriculture. This includes many impoverished Third World countries. Yet the EC refuses to budge.

EUROPE'S TRADING BLOCS

	Population 1990 (million)	GDP 1990 ($ billion)
EC	345	6,021
EFTA	32	868
Turkey	56	82
COMECON	120	656*
USSR**	290	1,600*
Total	843	9,227
U.S.	251	5,400

* *PlanEcon* Estimate, *1988.*
** Includes Asian portion of the Soviet Union.

Note: The lack of Western accounting measures and free prices makes estimates of the size of centrally planned economies unreliable.
Source: *PlanEcon Report*, U.S. Department of Commerce, EC Commission.

Heritage InfoChart

THE EC AND ITS EUROPEAN NEIGHBORS

The EC's economic clout will be extended further upon the expected completion this summer of negotiations between it and the six-member European Free Trade Association (EFTA). EFTA's current members – Austria, Finland, Iceland, Norway, Sweden, and Switzerland – have highly developed economies and are among the wealthiest countries in Europe.

Current EC-EFTA negotiations are aimed at lowering trade barriers between them and increasing economic coordination. The resulting bloc will be known as the European Economic Area (EEA). It will embrace virtually all of Western Europe and number almost 380 million people, with an aggregate gross domestic product of $6.9 trillion. Some EFTA members, meanwhile, are pursuing full EC membership: Austria has submitted a formal application; Sweden is likely to do so this summer. Less enthusiastic is Norway, whose voters rejected EC membership in a 1972 national referendum. But Norway may be forced into an ever-closer relationship with the EC due to its economic dependence on the EC and a lack of alternatives.

Outside of EFTA, Turkey has had an Association Agreement with the EC since 1963, but its application for full membership has been put on hold indefinitely by the EC. Turkey's relatively low level of economic development, its Muslim culture, and the hostility of its old antagonist, Greece – now a full EC member capable of blocking Turkey's application – make its prospects for full membership poor.[10]

On Hold. Each East European country has expressed interest in EC membership. In Poland, for example, all new economic legislation is drafted in accordance with EC standards. At present, however, the EC is too absorbed in its own political and economic integration to consider admitting new members and also is wary of the costs and risks of admitting such countries as economically backward Poland. French President François Mitterrand recently advised East European countries not to expect membership for several decades.

The EC's closed door is good news and bad news for these EC aspirants. While membership would open currently closed markets and be an important spur to growth, it also would subject the fragile East European economies to the rapidly increasing burden of EC regulatory policies, like stringent environmental standards and rigid employment practices. The weight of these policies could erase for Eastern Europe many of the economic gains resulting from the removal of trade barriers.

Instead of membership, the EC is offering to negotiate Association Agreements with the East European countries. In addition to regulating trade between East European countries and the EC, these agreements would hold out the possibility, though not a guarantee, of full EC membership.

Severe Disadvantage. Given the disparity in size and wealth between the EC and the East European countries, the East Europeans are at a severe disadvantage in these negotiations. Poland is a case in point. While demanding that Poland commit itself to eliminating all restrictions on imports from the EC, the EC has offered in turn to remove restrictions only on about one-half of Poland's exports. Limits on the import of Polish textiles and steel would be reduced, but only over five to ten years. Most Polish agricultural products would continue to face daunting barriers or would not be admitted at all. Coal exports would remain blocked.

The irony is that formerly communist Poland now has an economy that in many ways is more open than that of the EC; it has no quantitative restrictions on imports and has very low tariffs. Yet the EC is encouraging Poland and other liberalizing East European countries to raise tariffs to match those of the EC. Without an alternative, Poland will be forced to comply with the EC's demands.

10 Each EC member possesses a veto over the admission of new members. A recent opinion poll showed 99 percent of Greeks opposed to Turkish membership.

RECOMMENDATIONS

American interests argue strongly for promoting free trade within Europe and between Europe and the rest of the world. The key will be to push the EC off its present protectionist path toward free trade. Doing so will require a carefully coordinated seven-point strategy proceeding along several reinforcing fronts: the GATT negotiations; relations with U.S. trading partners around the world; U.S. relations with non-EC European states; and relations with the EC itself.

Points of the strategy are:

Point #1: Continue to use GATT as the main forum for liberalizing global trade; prevent the EC from torpedoing the GATT negotiations.

Despite its shortcomings, GATT has been a valuable tool in creating a relatively free international trading system. The latest round of trade liberalization negotiations, known as the Uruguay Round, is essential to maintain the momentum toward free trade. Throughout the Uruguay Round, America tirelessly has pressed the EC, to little avail, to reduce barriers to trade in agricultural products. As of now, a nearly complete GATT agreement is being held up by this single issue. Even if the talks fail in agriculture in this round, Washington should continue to use GATT to press for trade liberalization globally. GATT is a particularly useful forum to challenge EC protectionist practices as it can mobilize support from around the world.

Point #2: Expand the number of free trade agreements between America and other countries.

The U.S. already has signed free trade agreements with its largest trading partner, Canada, and with Israel. The Bush Administration currently is negotiating a free trade agreement with Mexico. Free trade agreements with other Latin American countries could follow, creating a free trade zone for the entire Western Hemisphere. After Mexico, Chile and Colombia are likely candidates. In addition to expanding U.S. business opportunities, these and other potential agreements demonstrate forcefully to the EC and other protectionists that America has the option of establishing its own free trade system and that countries that pursue protectionist policies risk exclusion from these and other markets around the world.

Especially important would be agreements with the East Asian nations of South Korea, the Republic of China on Taiwan, Thailand, and, eventually, Japan. In addition to the tremendous economic advantages to America presented by such agreements, they would create the prospect of a North American-East Asian free trade zone. This would mobilize tremendous pressure on the EC, which could not afford to be left out of what would be the world's largest trading group.

Point #3: Offer to negotiate free trade agreements with East European countries that have embarked on free market reforms.

Free trade agreements with the U.S. would give the East European countries secure access to the American market at a time when the EC is restricting access to agriculture, steel, textiles, and other sectors in which the East Europeans are competitive. Such access to the U.S. market was a key element igniting the dramatic growth of the East Asian economies.

While the immediate gain to U.S. business in new markets would be relatively small, opportunities will expand as the East European markets grow. Free trade agreements with the U.S. also would head off protectionist measures by East Europeans. Several countries now are considering such measures in an unwise attempt to protect their uncompetitive industries from foreign competition.

Moreover, American-East European free trade agreements, or even the prospect of them, will increase the leverage of these countries in their Association Agreement negotiations with the EC. Given their poverty, the East European countries are at a considerable disadvantage in these talks. A free trade agreement with America would give the East Europeans an alternative to the EC and thus would press the EC to open its markets to Eastern Europe. Open trade between the EC and Eastern Europe ultimately benefits the U.S., as long as Eastern Europe's barriers to U.S. trade stay down, because it opens a "back door" into the EC for American companies. U.S. companies, for example, could operate plants in Eastern Europe and export their output to the EC on terms that might be better than exporting directly from America to the EC.

Point #4: Begin laying the foundation for free trade agreements with the European republics of the Soviet Union.

The same advantages of free trade agreements with Eastern Europe and EFTA would apply to those republics of the Soviet Union that are on the road to independence. These include not only the republics that have elected democratic governments and have proclaimed independence as their goal – Armenia, Estonia, Georgia, Latvia, Lithuania, and Moldavia – but also those other European republics in which democratic forces may soon come to power and move toward independence: Byelorussia and Ukraine. Several of these republics have begun the transition to a free market economy, even though the Soviet central government continues to hamper their efforts. The prospect of a free trade relationship with America can encourage these nations to speed the transition.

A democratic, free market Russia, a potentially wealthy country of 150 million people and enormous resources, eventually will be a candidate for a free trade agreement with America. It is in America's long-term strategic interests that Russia become democratic and align itself with the West. Providing Russia with the opportunity to grow economically is the most practical way to achieve these goals.

Point #5: Complete the EC's encirclement by offering to negotiate free trade agreements with other non-EC European countries, particularly Turkey.

Although the six EFTA countries are negotiating with the EC for closer relations, several of its members are wary of getting too close to the EC and of being dominated by it. A free trade agreement with America not only would increase EFTA nations' trade opportunities but also would serve as a political and economic counterweight to the EC.

Turkey, which is not a member of either the EC or EFTA, is a particularly attractive candidate for a free trade agreement with America. Turkey has a large and dynamic economy and is searching for greater access to foreign markets. Its 1987 application for admission to the EC has been shelved. In October 1990, the Turkish government proposed a free trade agreement with the U.S. So far, Washington has done nothing to pursue this. A free trade agreement with Turkey would open new markets for American exports and would bolster the economy of a key American geostrategic ally, as demonstrated by Turkey's steadfastness in the Persian Gulf war. Along with free trade agreements with the EFTA countries to the north and the East Europeans to the east, a free trade agreement with Turkey would complete the encirclement of the EC by a U.S.-led free trade area.

Point #6: Split the EC.

In addition to applying external pressure to the EC, America should make use of its allies within the EC to prod the EC toward free trade. Britain and The Netherlands, for instance, favor freer trade. Germany, along with America the world's largest trader, has a vital interest in keeping its overseas markets open, although it often defers to protectionist sentiment for political reasons, such as pacifying its farmers or improving relations with France. The Bush Administration should consult with London and other appropriate EC capitals on ways of coordinating policy to halt EC protectionism.

Point #7: Ultimately, propose an American-EC Free Trade Agreement.

The culmination of American efforts should be a comprehensive free trade agreement with the EC itself. An American-EC agreement would eliminate the major threat to world trade and ensure that all of Europe is open to American business and to economic growth. The prospect of a "Fortress Europe" wreaking havoc on U.S. economic interests would be eliminated; instead, the EC could become an ally in promoting free trade in East Asia and around the world.

CONCLUSION

Europe's quiet economic revolution is as important as the political convulsions of recent years. For America, the stakes in this economic revolution are high. The familiar divisions of post-World War II Europe are fading and in their place a single continental economy may emerge, numbering over 600 million people. The creation of a dynamic economy embracing all of Europe and open to the world would greatly enlarge markets for American goods, talents, investment, and services. It would boost world trade as a whole. The alternative is a continent that remains divided into blocs, with the East mired in poverty and the West threatening global trade with its protectionism.

Not all American interests in this process are economic. Important American geostrategic concerns also are involved in promoting free trade in Europe: bolstering the economies of the new democracies of Eastern Europe, supporting its ally Turkey, and integrating all areas of Europe into the West.

America should not be a passive observer in Europe's economic revolution. Instead, America should pursue a strategy to advance American economic and strategic interests in an open and expanding European economy. The key to achieving this will be to push the EC, which is moving dangerously toward protectionism, toward free trade. This will take tremendous pressure, which can be applied only if America gradually builds a free trade area of its own — a free trade area so powerful that the EC will find itself on the outside looking in, and have no choice but to open its borders or risk permanent "second class" economic status.

Critical Intervention. This American strategy should have at least seven points. These are: continue pressure on the EC through the GATT process on liberalizing global trade; negotiate free trade agreements with Latin American and East Asia countries; offer free trade agreements to those East European countries that move decisively toward free market economies; offer similar agreements to Turkey and other non-EC countries of Europe; lay the groundwork for free trade with the European republics of the Soviet Union; split the EC by working with those countries that are opposed to protectionism; and finally, offer to negotiate a free trade agreement with the EC itself.

In the first decades after World War II, American intervention in European economic matters was critical to Europe's economic health and progress toward freer trade. Once again, America's influence will be needed if Europeans are to be spared the consequences of their governments' protectionist actions, and if American interests are to be preserved.

Douglas Seay
Policy Analyst

On Eastern Europe, see Heritage Foundation *Backgrounders* No. 820, "An American Response to the Balkan Revolutions" (March 29, 1991); No. 796, "Yellow Light for Eastern Europe: Beware Four Economic Development Myths" (November 13, 1990); No. 776, "Promoting the Peaceful Decolonization of the Soviet Union" (July 12, 1990); and No. 759, "For Eastern Europe, An Agenda for Economic Growth" (March 13, 1990).