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*The U.S./EC Relationship:
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The U.S./EC Relationship: Friends and Competitors

by Murray Weidenbaum

The increasing economic integration of Western Europe resulting from the essential completion of the EC 1992 agenda is an appropriate time to consider the problems and potentials of the developing economic relationship between the United States and the European Community.¹

EC-1992 and Beyond

This presentation analyzes the U.S./EC relationship from admittedly an American point of view. Let us begin with the ongoing economic unification of Western Europe. To an economist, the creation of the single market as it unfolds during the 1990s is essentially a positive event, yet one destined to generate winners and losers on both sides of the Atlantic. Because the formation of the United States represented in a very real sense the creation of the original common market, Americans are basically supportive of the community's efforts. We have been so from the outset, going back to the creation of the original European Coal and Steel Community, the predecessor to the current European Community.

However, the business and economic relationships among our nations are bound to become more intricate as we both compete in what is increasingly a global marketplace involving numerous third — and fourth — parties. It is vital, therefore, that the European Community and the United States each develop a better understanding of how to be friends and competitors simultaneously during the years ahead. In that spirit, we must acknowledge that, from the vantage point of American business firms, the rise of the European Community presents both threats and opportunities.

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The fundamental positive economic factor flowing from developments in the EC is, of course, that the 12 countries have been reducing restrictions on business, trade, and labor. Many of the goals associated with the creation of a single EC market and the integration of commercial, financial, and cross-border markets were met with the implementation of the EC 1992 program, which in large measure went into effect at the beginning of 1993. Despite some gaps in implementation, people as well as goods and investments are now able to move much more readily from one of the common market nations to any other. That is bound to make Western European businesses more efficient as they achieve greater economies of scale and as standardization replaces 12 varieties of many products and services. The participation of the EC as a single entity representing its member states in the multinational GATT tariff negotiations is another important step in the integration process.

However, the big negative — from the viewpoint of other nations as well as the EC's own consumers — is that the trade wall around the EC is not coming down. In the words of the Federal Reserve Bank of Chicago, "Not only did formation of the EC result in a reduction in restrictions on trade between members, it began the process of setting *common trade restrictions against nonmembers*."² The contrast between these two very different movements is quite striking.

Actually, the EC is toughening its external barriers to commerce. Enlightened economists are not supposed to use pejorative terms such as Fortress Europa, so let us cite some numbers instead. In 1960, more than 60 percent of the foreign trade of the 12 EC members was outside of the EC. In 1992, 61 percent of their trade remained in the EC.³ This is a complete reversal.

The current ratio is bound to rise further for two reasons. The first is the increasing economic integration of the EC-12. The second force moving in the same direction is the six countries in the European Free Trade Association (EFTA) who are joining in a formal trade association with the Community to form a European Economic Area. Those six are Austria,

Finland, Iceland, Liechtenstein, Norway, and Sweden. For the time being, Switzerland rejected participating via a national referendum.

Complying with the terms of the European Economic Area will anticipate approximately two-thirds of the adjustments in national laws necessary for full EC membership. The trade linkages are already very strong. Austria, for example, purchases 69 percent of its imports from the EC nations which, in turn, buy 65 percent of its exports.⁴

Our friends in Brussels tell Americans not to worry about these developments, and that the EC's trade restrictions, such as reciprocity and domestic content rules, are aimed at Japan. However, we do not know how good their aim is. The same restrictions that affect Japan can keep out goods produced in the United States, whether by domestically owned firms or by factories in North America which are transplanted from Asia. Moreover, if the products of Asian rim countries are kept out of Europe, the Western Hemisphere is their major alternate market. So, in the interconnected global economy which now exists, Americans have a vital interest in the maintenance of open trading patterns around the world. EC purchasers, whether family consumers or industrial buyers, likely have very similar interests.

The impacts of greater EC economic unification will surely be uneven, as is expected of any dynamic process. The most likely winners will include the stronger European companies with high labor skills and high-tech production capabilities. They will be enjoying the benefits of both economies of scale and growing domestic markets. These firms also bring a special understanding of European needs, capabilities, and cultures. Many of these enterprises should emerge larger and stronger than ever.

In contrast, losers from greater EC economic unification may well include high-cost European companies that have been sheltered within their own national markets. Some of these more tradition-bound firms will be hurt by new continent-wide competition. The economically backward areas — the mezzogiornos — may fall further behind. Of course, not all barriers will be down. Each member nation continues to possess individual values, needs, cultures, language — and tax systems. No matter what changes the EC makes, the French are not going

to make a stampede for German wine. The British will still want cars with steering wheels on the "wrong" side.

Likely winners will also include many strong U.S. firms with an established presence in Western Europe. The implications of that presence, it turns out, are ambivalent. The overwhelming majority of goods sold in the EC by American multinational firms is produced in the EC by European workers. Only a small fraction of the products sold by American multinationals in the EC is made in the United States and then shipped to Europe for sale by their local subsidiaries.⁵

The rationale for American firms favoring direct investment in Europe over exports from the United States was made clear by a representative of Pfizer, the American pharmaceutical firm:

Pfizer does not have a choice about whether to manufacture in the European Community or not. If we are going to sell in Europe, we have to manufacture there.⁶

Quite a few U.S.-based companies have encountered similar experiences. However, once established in Western Europe, these enterprises have some special advantages. These high-tech, well-capitalized companies are accustomed to competing on a continent-wide basis. They can use one EC country as a base to sell to the other eleven. General Motors and Ford currently have more Europe-wide strength than such European automakers as Volkswagen, Fiat, Peugeot, and Renault. The same holds true for computer manufacturers such as IBM, Digital Equipment, Unisys, and Hewlett Packard compared to their European counterparts.

On the other side of the ledger, quite a few U.S. firms are likely to be losers from the creation of the single European market. They will find it more difficult to export to Western Europe. Looking beyond the initial adjustment period, U.S. exports to the EC are estimated to be 2-3 percent lower than they would be in the absence of European integration.⁷ U.S.-based companies also will face tougher competition from the stronger EC businesses in their domestic markets. The expected losers will include many provincial American companies who have not yet awakened to developments across the Atlantic.

On balance, there is a positive thrust to these changes in the economic relationship between the European Community and the United States. From the viewpoint of the United States, Western Europe now presents a potential market for a wide range of products and services far greater than most Americans appreciate — and the benefits should flow in both directions. The EC is the largest customer of U.S. products and, at least until the most recent period, its imports from the United States exceed its exports to the United States in most recent years. Here are a few examples of the ways in which U.S. and EC companies are developing closer business relationships:

- Ford has agreements with Cosworth in the United Kingdom and Porsche in Germany for the design and development of car engines used in the models it produces in Europe.
- IBM purchased minority equity stakes in more than 100 software and computer service companies in Western Europe between 1990 and 1992.
- Some models of Boeing commercial jet transports use engines made by the United Kingdom's Rolls-Royce, especially for European airlines. For its new 777, Boeing has entered into partnerships with Italy's Alenia to produce the outboard wing flaps and with General Electric of Britain for the primary flight computers.
- Otis' new elevator, the Elevonic 411, uses electronics designed by its Germany subsidiary, door systems made by its French branch, and small-gear components produced by its Spanish division.
- Unisys is simultaneously a customer of, and a supplier to, Switzerland's BASF, the Netherlands' Philips, and Germany's Siemens — and also competes with each of these Western European electronics giants.
- Digital Equipment Corporation and Italy's Olivetti & Co. jointly fund and share the results from Olivetti's research laboratory in Cambridge, England.
- General Electric and Pratt & Whitney are cooperating with Rolls-Royce and France's SNECMA to develop quieter, more economical, and cleaner-burning aircraft engines.
- McDonnell Douglas is working on development of a new radar-equipped version of the Harrier II (a vertical take-off and landing aircraft) jointly with Alenia, British Aerospace, and CASA of Spain.
- Pacific Telesis is a 26 percent participant in a joint venture led by Mannesmann to provide mobile telephone service in Germany. The

American company also holds a 23 percent stake in Telecel, an international consortium building a cellular phone system in Portugal.

Not all developments in the EC have been positive, even from a European viewpoint. Considerable concern has been aroused by the failure of the EC-12 to move more rapidly in approving and carrying out the Maastricht agreement. In retrospect, the early rush to monetary union was faster than could be reasonably sustained. Progress surely will be more cautious in the years ahead but some positive movement may well continue. Individually, many market-oriented economists sympathize with the reluctance of the citizenry to increase the already substantial power of the EC bureaucracy and of central bankers.

The simultaneous failure of Western Europe to take a forceful stand on the contentious Bosnia issue also has contributed to a feeling of unease in assessing future progress in the Community. However, these political setbacks should not deflect from the genuine accomplishments made in integrating the production, trade, and financial markets of Western Europe.

Moreover, the EC is a dynamic and not a static concept. The Community started with six member nations and gradually doubled that number. Twelve will not be the end of the line. Many other European nations are seeking admission, aside from the special case of East Germany, which already has been unified with West Germany. As outsiders, we can only speculate that the applications of Sweden, Finland, and Norway will be approved fairly expeditiously. Denmark's existing membership is a constant reminder to the other Scandinavian nations of the benefits of Community membership.

Austria's entrance into the EC would be especially strategic, in view of Vienna being a major gateway to Eastern Europe. The Czech Republic, Hungary, and Poland already have each signed preliminary protocols with the EC. It is likely that their relationship, at least initially, will be that of associate members. Slovakia may be a fourth member of that category and perhaps ultimately joined by one or more of the newly independent Baltic republics.

Surely, if the Eastern European nations can get their political and economic acts together, they could become low-cost suppliers to Western Europe — or competitors — or both.

Now consider the impact of the EC going from 12 members to 15 or 20 or more. Adding together all those gross domestic products shows that, later in the 1990s, Western (and Central) Europe will become the world's largest consolidated marketplace and, conceivably, the center of gravity once again of the international economy. That, in turn, requires us to analyze, albeit briefly, the key trends in the rest of the international economy.

The Rise of the Other Regional Groupings

The Asian rim economies are growing rapidly and now constitute a very large regional concentration of economic resources. They are also growing together, although not in a formal structure such as EC or EFTA. An examination of the substantial flows of investment from within the Asian rim — especially from Japan, Taiwan, and South Korea — to the newer industrialized nations in the area such as Thailand, Malaysia, and Indonesia is instructive. Most of their investment capital comes, not from Europe or North America, but from Asia itself. Not too surprisingly, the development of a unified trading area is now taking place in that part of the world. In some cases — notably Malaysia and Indonesia — Japan has become their leading trade partner, for exports as well as imports. By 1995, it is likely that Japan will provide the largest market for the exports and perhaps also the imports of most of the Asian rim nations.

The other more advanced economies in the Pacific rim — notably South Korea, Taiwan, and Hong Kong — are also large providers of investment capital and have become key trading partners for the less economically advanced nations in this region. For example, Hong Kong and the neighboring Chinese province of Guangdong have generated a very considerable cross flow of investment; 50,000 managers and professionals commute daily from Hong Kong to Guangdong. Most of the actual manufacturing activity for Hong Kong-based industries is now performed on the mainland. In fact, what some observers call the greater "Hong Kong

enclave" enjoys a gross domestic product approximately that of France and it is growing more rapidly.⁸

Economists are not especially enamored of inward-looking regional trading blocs. Thus, American economists can describe the likely extension of the U.S.-Canadian Free Trade Agreement to include Mexico (NAFTA) as essentially an inevitable response on our part to the market consolidations that are proceeding so swiftly both in Western Europe and in East Asia. Surely, it is important to note that, in the case of the EC as well as NAFTA, this process is essentially a positive one, focusing on reducing barriers to commerce.

Important questions then arise: will regionalization improve the relationship between the United States and Western Europe or will we go our separate ways? Will regionalization reduce or increase the volume of world trade? The first question is very judgmental. The second involves data that are very difficult to interpret. On balance, the continued rise in regionalization is likely to coincide with the growth in international commerce. However, it will not be a simple cause and effect relationship. It is another development — the globalization of business — that will pace the growth of world trade. Continual technological advance, especially in transportation and communication, will be a far more powerful force than any static governmentally imposed restraints. Let us explore these relationships.

Regionalization Versus Globalization

It is commonplace to say that France exports wine and Japan sells automobiles to the United States and that the United States exports jet airliners to both. In truth, though, nations and governments do little more than record, and tax, those cross-border transactions. It is private, profit-seeking enterprises that typically engage in international commerce.

Examining foreign trade from this viewpoint provides new insights. For example, in the case of the larger, more industrialized nations, about one-half of what governments call foreign trade actually involves cross-border transactions between different parts of the same company. That ratio holds true for Western Europe, the United States, and Japan. An

increasingly common occurrence is a domestic firm shipping goods to or receiving items from an overseas subsidiary — or a foreign firm engaging in similar transactions with its divisions in other countries.

In a traditional sense, all this is foreign commerce. From an economic viewpoint, however, these international flows of goods and services are internal transfers within the same firm. Perhaps the most telling case was cited by former U.S. Secretary of State George Shultz. He tells of a shipping label on integrated circuits made by an American firm, which read: "Made in one or more of the following countries: Korea, Hong Kong, Malaysia, Singapore, Taiwan, Mauritius, Thailand, Indonesia, Mexico, Philippines. The exact country of origin is unknown."

That is the global enterprise in full swing. This incident also illustrates the degree to which businesses are generating an increasingly more global outlook transcending regional blocs, no matter how powerful or carefully structured. This broader perspective underlies the strategies that transnational enterprises employ to respond effectively not only to increased competition, but also to the inhibiting effects of regionalization.

Here is a rather unusual example of cross-border commerce to illustrate the power of technology in shaping the strategies of the global enterprise: The day of the Iraqi invasion, the manager of a Kuwaiti bank faxed the bank's records page by page to his office in Bahrain. He was forced to stop several times because the gunfire seemed to be coming closer. By day's end, however, he had successfully sent by fax all of the bank's key documents. Having moved this vital information, the bank opened for business the next day as a Bahraini institution. Thus it was not subject to the United States freeze on Kuwaiti assets or to Iraqi control. The bank literally was transplanted from one nation to another by technology.

Technological progress — especially in the fields of communication and transportation — makes possible a variety of business innovations that often overcome the obstacles imposed by governments. Cross-border joint ventures and strategic alliances have moved from the classroom to the boardroom. They are increasingly common in high-technology industries

where few companies possess the resources, the technical ability, or the willingness to undertake on their own the risk of a costly new venture. Electronics companies in Europe, Asia, and the United States engage in joint ventures to develop new products, and co-produce existing products. The same firms serve as sources of supply for each other, are customers of each other — and compete against each other.

There is no set pattern. Partially-owned subsidiaries, associated firms, licensing, franchising, and correspondent relationships are all increasingly popular ways businesses respond to changing threats and opportunities in the global marketplace. Immunex Corp., a small biotechnology firm in Seattle, Washington, licenses five products for production and sales by the giant Swiss firm Hoffman-LaRoche. Jiffy Lube, Hertz, Budget Rent-A-Car, Rainbow International (a carpet dyeing and cleaning company), and Mailboxes Etc. have franchised many European-based firms to provide the type of services they originally designed for American customers.

The insurance services firm Alexander and Alexander maintains correspondent relationships with All Risk of Norway and Aegis Insurance Company of Greece. It also owns large minority stakes in France's Société Generale de Courtage d' Assurances and in Ganat Alexander of Spain. A major portion of Corning Glass' revenues comes from joint ventures with Germany's Siemens, Switzerland's Ciba-Geigy, and the United Kingdom's Plessey.⁹

Clearly, technology and business innovation are outpacing traditional political thinking about international relations. The standard geopolitical map is out of date compared with the emerging map of business and economics.

An Optimistic Long-Run View

While private enterprise is increasingly global, government policy nevertheless usually remains very parochial. Understandably, voters still care about the jobs in their country, state, province, and locality. And politicians are not reluctant to exploit those concerns. However, when we examine how the public sector deals with economic issues, it is hard to sustain a

feeling of awe. Take the highly visible subject of EC agricultural subsidies. This is a subject that has occupied a considerable amount of the time and energy of U.S. and EC trade negotiators. Yet, it is useful to examine the operation of those supposedly awesome obstacles to commerce. Here is an excerpt from the 79-page book of instructions published by the UK Ministry of Agriculture, Fisheries, and Food. This section of the manual, which is supposed to instruct farmers how to apply for aid under three of the EC's subsidy schemes, has been described as one of the livelier passages of the book:

If you are claiming only Beef Special Premium and/or Suckler Cow Premium *and* are exempted from the stocking density rules, you need not submit an area aid application. You are exempt from the stocking density rules if your total number of Livestock Units (LUs) is not more than 15. This total is based on any milk quota you hold on April 1, 1993, sheep on which you have claimed Sheep Annual Premium in 1993, and cattle on which you are claiming Beef Special Premium or Suckler Cow Premium in 1993. Further details of the calculation of stocking density and LUs are set out in paragraphs 44 to 57 of the explanatory booklet "CAP Reform in the Beef Sector." *You will, however, need to submit an area aid application if you wish to claim extensification premium* (see paragraphs 58 to 61 of "CAP Reform in the Beef Sector").¹⁰

There is another and ultimately more powerful force that comes into play in international commerce: the consumers who vote every day of the week, in dollars, guilders, marks, yen, pounds, francs, and lira. That is a compelling reason to end on an upbeat note when pondering the future of the international economy in general and of U.S.-EC relationships in particular.

In each of our nations, the same voters, as consumers, buy products and services made anywhere in the world. They may vote protectionist, but their daily buying patterns are oriented to free trade. Consumers in each of our nations give far more weight to price and quality than to the product's country of origin. Without thinking about it, consumers are adapting to the global economy. After all, if consumers were not open to the global marketplace, the pressures on government to restrict international trade would not arise in the first place.

In the years ahead, the combined power of economic incentives and technological change will increasingly compel voters and government officials to wake up to the positive

implications of the global economy. In a basic sense, the mobility of enterprises — of their people, capital, and information — is reducing the power of government. Public-sector decision makers increasingly are being forced to understand that they now have to become internationally competitive in the economic policies they devise. Government programs that impose costs without compensating benefits or that reduce wealth substantially in the process of redistributing income undermine the competitive positions of their own domestic enterprises. The result is either the loss of business to firms located in other nations or the movement of the domestic company's resources and activities to more hospitable locations.

Political scientists and economists have long since understood and every American school child is taught that people vote with their feet. They leave regions and nations with limited opportunity in favor of those that offer a more attractive future. In this era of computers, telephones, and fax machines, enterprises are far more mobile than that. The fear of losing economic activity to other parts of the world will surely reshape in fundamental ways the domestic political agendas of the coming decade.

Therefore, despite the difficulties being encountered by governments negotiating at GATT, we can be optimistic about future trends of world investment and commerce. Even if many of those public-sector barriers remain, the private sector will increasingly learn how to overcome them or even just to live with them. Of course, there are costs involved when businesses respond to governmental barriers to international business. At times, the costs of crossing these borders may be very substantial, especially in the short run. However, in a global economy, these barriers become far from absolute.

Conclusion

The tension between business and government is not new, but the required adjustments may actually reduce the frictions between governments by bringing closer together the people and private institutions of each of our nations. The traditional problems of international relations are being exacerbated by the rapid rate of social, economic, and technological change

around the globe. But, as a result, the real liberalization of international trade and investment — and the creation of a truly global marketplace in the years ahead — will be achieved, not from changes in government policy, but from the competition among firms in the private sector of the various national and regional economies.

The rapidly changing global marketplace of the 1990s, and likely beyond, will provide both threat and opportunity for business firms, governments, and consumers. Invariably, developments such as the achievement of the single market will generate both winners and losers. The outcomes for specific individuals and organizations will depend in large part on their ability to understand and to respond effectively to ever-changing economic and technological trends.

While governments continue to react to the global marketplace with new regional associations, businesses will keep on trying to overcome or at least to adjust to these barriers and policies in their relentless effort to meet the needs of their customers.

Looking out toward the twenty-first century, we can readily envision the business firms and consumers of both North America and Western Europe becoming tied far more closely together than is the case today. Happily, those alliances and other cooperative relationships will not be forced by governments. Rather, they will be encouraged by economic opportunities and technological possibilities. We indeed will learn how simultaneously to be friends *and* competitors.

Notes

1. This paper draws on material in Murray Weidenbaum, "The Shifting Roles of Business and Government in the World Economy," *Challenge*, January/February 1993, pp. 23-26, and Murray Weidenbaum, *Regionalization Versus Globalization* (Washington, D.C.: Konrad Adenauer Stiftung, 1992).
2. Jack L. Hervey, "Europe at the Crossroads," *Chicago Fed Letter*, August 1993, pp. 1-2.
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5. Robert Lipsey, *American Firms Face Europe: 1992* (Cambridge, Mass.: National Bureau of Economic Research, 1990).
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