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**Working Paper**

## How will 1992 affect the rest of the world? The reactions of some major countries and trade blocs towards EC integration

Bank of Finland Discussion Papers, No. 24/1988

**Provided in Cooperation with:**

Bank of Finland, Helsinki

*Suggested Citation:* Skolnik, Amy (1988) : How will 1992 affect the rest of the world? The reactions of some major countries and trade blocs towards EC integration, Bank of Finland Discussion Papers, No. 24/1988, ISBN 951-686-171-7, Bank of Finland, Helsinki, <https://nbn-resolving.de/urn:nbn:fi:bof-201908051333>

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ABSTRACT

Given the interdependence of today's global markets, it would be impossible for European integration to occur without affecting the rest of the world. The current triangle between the U.S., Japan, and EC is very prone to avoid the others' influences. However, it is a matter that the EC should not neglecting and with the coming of 1992, many countries fear that the internal market will result in a rise in trade barriers and protectionism for everyone outside. This paper looks at the reactions and concerns of the U.S. and Japan towards the internal market as well as EC relations with Eastern European and EFTA countries. Though the true affect of the internal market is not clear, the EC Commission claims that the internal market will be a benefit to the world. The world is discussing alternative methods and the possibility of new trade associations. With this international cooperation in mind, it is not in the EC's best interest to alienate itself from the rest of the world's markets.

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Bank of Finland Economics Department  
4.11.1988

24/88

HOW WILL 1992 AFFECT THE REST OF THE WORLD?

THE REACTIONS OF SOME MAJOR COUNTRIES AND  
TRADE BLOCS TOWARDS EC INTEGRATION

TIIVISTELMÄ

Kansainväliset markkinat ovat siinä määrin toisistaan riippuvaisia, ettei Euroopan integraatio voi olla vaikuttamatta muihin maailmaan. Yhdysvaltain, Japanin ja EY:n välinen kolmio on niin herkkä, ettei yksikään osapuoli voi välttyä toisten vaikutukselta. Tämä on kuitenkin asia, jota EY näyttää laiminlyövänsä vuoden 1992 lähestyessä. Monissa maissa pelätään sisämarkkinoiden johtavan kaupan esteiden ja protektionismin lisääntymiseen yhteisön ulkopuolista nähdessä. Tässä selvityksessä tarkastellaan sisämarkkinoiden yhteyksiä Japaniin ja Japanissa nostattamia reaktioita ja huolenaiheita samoin kuin EY:n suhteita Itä-Eurooppaan ja Efta-maihin. Vaikka vuoden 1992 toteutuminen vaikuttaa on mahdollonta, on selvää, että maailman markkinat eivät ole täysin erillään Euroopan markkinoista.

Helsinki 1988  
122M 071-688-171-7  
122M 0705-3875



Suomen Pankin monistuskeskus  
Helsinki 1988  
ISBN 951-686-171-7  
ISSN 0785-3572

#### ABSTRACT

Given the interdependence of today's global markets, it would be impossible for European integration to occur without affecting the rest of the world. The current triangle between the U.S., Japan, and EC is very precarious and none of these countries can avoid the others' influences. However, this is a matter that the EC seems to be neglecting and with the coming of 1992, many countries fear that the internal market will result in a rise in trade barriers and protectionism for everyone outside. This paper looks at the reactions and concerns of the U.S. and Japan towards the internal market as well as EC relations with Eastern European and EFTA countries. Though the true affects of 1992 are impossible to predict, and the EC Commission claims that no "European fortress" is being built, many of its actions indicate otherwise. In response, much of the rest of the world is discussing alternative methods and the possibility of new trade associations. With this international cooperation in mind, it is not in the EC's best interest to alienate itself from the rest of the world's markets.

#### TIIVISTELMÄ

Kansainväliset markkinat ovat siinä määrin toisistaan riippuvaisia, ettei Euroopan integraatio voi olla vaikuttamatta muuhun maailmaan. Yhdysvaltain, Japanin ja EY:n välinen kolmio on niin herkkä, ettei yksikään osapuoli voi välttyä toisten vaikutukselta. Tämä on kuitenkin asia, jota EY näyttää laiminlyövän vuoden 1992 lähestyessä. Monissa maissa pelätään sisämarkkinoiden johtavan kaupan esteiden ja protektio-  
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tuksia on mahdotonta ennustaa ja vaikka EY:n komission mielestä ei



minkäänlaista "Euroopan linnaketta" ole rakenteilla, monet komission toimet viittaavat päinvastaiseen suuntaan. Vastareaktiona tähän suuri osa muuta maailmaa käy keskustelua vaihtoehtoisista menettelytavoista ja uusien kauppaliittojen mahdollisuudesta. Tämän kansainvälisen yhteistyön huomioonottaen ei EY:n intressissä ole etääntyä maailman muista markkinoista.

Kansainvälinen markkinat ovat siten määrin toteutettavissa, jos Euroopan integraatio on ja vaikutus on maailman. Yhdysvaltojen, Japanin ja EY:n välisen kolmion on nähtävä, että yksikään osapuoli voi väittää toisten vaikutuksista. Tämä on kuitenkin asia, jota EY näyttää jatkuvasti jättävän huomiotta. Monet näkökulmat nähtävyyden yhteyden ulkopuolelta nähdään. Tässä selvityksessä tarkastellaan kansainvälisten Yhdysvaltojen ja Japanin välisiä suhteita markkinoiden ja Euroopan ja EY:n välisiä suhteita. Yhdysvaltojen ja EY:n välisiä suhteita tarkastellaan EY:n suhteita Yhdysvaltojen ja EY:n välisiä suhteita. Yhdysvaltojen ja EY:n välisiä suhteita tarkastellaan EY:n suhteita Yhdysvaltojen ja EY:n välisiä suhteita.

ISSN 0785-3572  
1988-951-886-171-7  
1988-951-886-171-7

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A prime example of this fear is the recent discussion in the U.S. and Japan about the possibility of a "European fortress" being built. As the U.S. and Japan approach 1992, the rest of the world is attempting to position themselves favorably so as to not get left out of the single market. Even the East bloc countries have shown an increased interest in forming trade agreements with the EC nations. However, as the Commission directives slowly unfold, the rest of the world must wait and wonder if a Europe without internal frontiers will mean walls of protection for everyone else.

## 2. The U.S. Fears a European Fortress is Being Built

The United States has actively been following the state of the internal market since their inception in 1993. The U.S. is the largest trading partner with \$145 billion worth of goods and services crossing their borders in 1987. In 1987, the trade relationship between the two markets is estimated at \$224 billion. Combining this with cultural and historic ties between the two areas, and it is apparent that a changing European market has important implications for the U.S.



## 1 Introduction

The member states of the European Community (EC) have launched a plan to create an internal market, by 1992, which will provide for the free flow of goods, services, capital, and labor across all their borders. In principle, the world should welcome this ambitious undertaking. Global trends have been towards increasing liberalization and removing all types of trade barriers. The U.S. in particular is frequently demanding increased access to and the opening of foreign markets. However, there is an air of caution emanating from the rest of the world surrounding the internal market plan. There is a fear, among Europe's major trading partners, that the EC single market will bring more harm than prosperity by resulting in an increase of external barriers and a return to protectionism.

A prime example of this fear is the recent discussion in the U.S. and Japan about the possibility of creating a free trade agreement. As 1992 approaches, the rest of the world is attempting to position themselves favorably so as to not get left out of the single market. Even the East-bloc countries have shown an increased interest in forming trade agreements with the EC nations. However, as the Commission directives slowly unfold, the rest of the world must wait and wonder if a Europe without internal frontiers will mean walls of protection for everyone else.

## 2 The U.S. Fears a European Fortress is Being Built

The United States has actively been following the plans for the internal market since their conception in 1985. The EC is the U.S.'s largest trading partner with \$145 billion worth of goods and services crossing between their borders in 1987. Direct investment between the two markets is estimated at \$224 billion. Combine this with cultural and historic ties between the two areas, and it is apparent that a changing European market has important implications for the U.S.



The U.S. has been advocating a removal of trade barriers and opening of markets for years. The EC Commission has repeatedly stated that the program will not result in a "European Fortress", so that it should have many advantages for American business. In addition, a more prosperous European Community would bring, not only economic benefits, but would strengthen the democratic world politically. Europe would be able to provide a larger portion of its defence expenses and assume a greater role of responsibility in world affairs. In opening its markets to the world the EC may also help further integrate the Eastern European economies. Once countries are economically integrated, they have more incentive to cooperate and work together on other issues. Despite U.S. apprehensions, the EC seems eager and willing to take on this new role in its efforts to maintain a competitive position relative to the U.S. and Japan.

However, recent statements by the EC Commission have not been so encouraging. The advantages from creating a single market will not be automatically extended to third countries; rather the EC will require complete reciprocity in return. The concept of reciprocity is extremely troubling to the U.S., as well as to other nations. Last year when a similar provision was included in a draft U.S. trade bill, the EC complained loudly that it was an intolerable protectionist measure. Yet it is very difficult to find much difference between that provision and the current European position. The EC Commission has argued that in sectors not covered by the GATT (General Agreement on Trade and Tariffs), it has the right to require reciprocal treatment. This could seriously threaten the recent progress towards international, multilateral trade liberalization, though the EC would not be the only player to blame.

Other areas that are of concern to the U.S. are direct investment, transparency, and protection of special industries. American subsidiary companies, already established in the EC, are supposed to be entitled to the same rights and privileges under EC law. Even so, the U.S. is apprehensive that the single market may lead to discrimination among these firms, and those from other outside countries, based on their nationality.

The U.S. has warmly welcomed the Commission's declaration that the internal market will be created in an open and transparent fashion. This is very important because directives can have unintended, hidden affects. In this way, third countries can comment on proposals before they are finalized. However, in practice the U.S. has found that directives are often passed before outside comments have even been received. The Commission defends this by saying that opportunity to comment is a privilege, and that ultimately decisions are based on European conditions. Yet the U.S. claims that secrecy only adds to mistrust and misunderstandings.

Lastly, the U.S. is worried about previously protected industries. In the face of full competition, it is only natural that certain sectors and regions, that have been carefully insulated in the past, will require some transition period. Nevertheless, the U.S. is concerned that previous member state's rules will now simply be transferred to EC-wide regulations; thereby actually increasing barriers in some countries. For example, the Commission is discussing replacing individual country quotas for automobiles with a temporary Community wide quota to aid in the transition of the automobile industry. However, past experience shows that "temporary" measures often have a way of becoming permanent; especially when dealing with an industry as important as the automobile one.

### 3 Japan-EC: Strengthening the Trade Triangle

Japan has also been watching the progress of the internal market. Yet, unlike the U.S., it has been doing so at a distance as EC-Japanese relations have historically been the weakest side of the triangle. Past relations between the EC and Japan were focused almost exclusively on commercial disputes. With the coming of 1992, the two hope to now concentrate on broader areas of cooperation. The strengthening of this relationship has been pursued more vigorously on both sides in the past year and the new Japanese Prime Minister Takeshita has made it a central issue during his two European tours this past Spring. The plan includes collaboration on cultural,



political, and scientific issues, as well as further economic aspects. However, closer EC-Japanese links are still in a planning stage.

For the Japanese, there are a number of reasons for this sudden shift in emphasis. One is that over the past few years, the U.S. has been perceived as a less reliable ally and a less tolerant trading partner. In addition, because of its relatively new economic wealth, Japan has a feeling of independence that it has not felt since World War II. Yet the main reason for strengthening European relations, is the EC's 1992 internal market plan. Japan is fearful that the single market will result in additional, more complex trade barriers that are even more restrictive than the present ones.

Japanese businessmen are eager to take advantage of the opportunities afforded by the European internal market, but like their American counterparts, they too are worried about direct investment, reciprocity, and protection. Last year saw a dramatic 90% increase in Japanese investment in the EC, reaching \$6.58 billion. This reflects both an optimism, and the anxiety that investment will be more difficult after 1992. The Japanese have also begun changing their approach towards manufacturing. They are turning away from the 'screw driver plants' that have gotten them in so many dumping disputes with the EC and attempting to become more integrated in the local community. They have watched many U.S. firms, like Ford and IBM, become practically European, thereby gaining the support of local government.

The issue of reciprocity is particularly troubling as Japanese investment has been concentrated in the financial sector which is not covered under any GATT agreements. Combine this with the fact that the Japanese financial sector has traditionally been very closed, and Japan stands to lose much of its European financial business. Of course, on the other hand, the EC demand for reciprocity may finally force the Japanese to open up their financial industries; a move that the rest of the world would welcome.

The protection of special industries is also of similar concern to Japan as to the U.S. Perhaps even to a greater degree due to Japan's

concentration in electronics, computers, and automobiles. Japan is apprehensive that the member state with the most conservative policy will set the pace. If this is the case, then for example in the automobile industry, Japanese exports will be substantially reduced as currently France restrict Japanese car imports to 3% of its market and Spain allows no Japanese auto imports at all.

#### 4 East Meets West as Trade Cooperation Increases

Like the Western world, the East European countries have also been observing the EC integration process with great interest. Besides the historical and cultural ties between East and West Europe; there appears to be an increased desire lately, in both regions, to coexist peacefully and prosperously. In 1987, trade between the EC and Comecon (SEV) countries reached almost 10% of total EC trade. For the East, increased economic ties help strengthen their faltering economies. For the West, economic interdependence adds stability to the political climate and provides access to new markets.

In 1984, EC-Comecon relations regained momentum after a stalemate period. The Comecon countries took a new, more flexible approach towards negotiations and no longer demanded that specific areas of cooperation and trade policy provisions be included in joint agreements. The first round of high-level negotiations occurred in September 1986 and were highly successful in opening up a concrete dialogue. An EC-Comecon joint declaration has since been signed, as well as the establishment of bilateral relations and discussions between individual EC members and most East European countries.

Closer links between the two Europes have also been fostered through joint ventures. West European businesses see joint ventures as a way to obtain access to an enormous market with enormous needs. East European companies are lured by technology and capital. In 1987 East-West joint ventures reached a total of 166 compared with 75 at the end of 1986 and only 5 in 1981. A UN study has estimated that the total value of pledged foreign investment in the Comecon countries is



about \$500 million. West Germany leads the Western side in most ventures at 36, while the majority in the East, 111, are with Hungarian companies. Despite the optimism and increased cooperation, most joint ventures still exist primarily only on paper. There are many obstacles such as lack of raw materials, legal uncertainties, procurement problems, and the inability to repatriate profits to the Western partner.

Recently, as progress towards the internal market continues, there has been a rush by many Comecon countries, to sign trade agreements with the EC, prior to 1992. In June 1988 Comecon and the EC officially recognized one another and in July, the EC signed or extended trade agreements with Hungary, Czechoslovakia, and Romania. Even so, a wide range of quota restrictions still exists for East Bloc nations due to EC fears that they will dump their products on Western markets if unregulated. Only Hungary has had all of its quota restrictions lifted which many see as a reward for its progress in liberalizing its economic system.

#### 5 Politics as Usual Play a Crucial Role

In creating a single market, the EC is hoping not only to regain its economic competitiveness, but also to exert a more powerful political will. This can particularly be seen in the recent discussions between the EC and the Soviet Union. Trade talks continue this Autumn and there is a possibility of reaching an economic agreement based on "reciprocity and mutual advantage". At present, the Soviet Union accounts for less than 4% of total EC exports. Mr. de Clercq, the EC Commissioner for External Affairs, has said that improved business facilities and greater market access would be key EC issues in any Soviet negotiations.

EC Soviet talks however, have made many U.S. officials nervous. They are concerned that the EC may take a different stance on issues than the U.S. led NATO alliance. Besides the practical implications of this, such as diverging opinions on arms control, it is likely that

the U.S. simply feels threatened by this new, more dominant role the EC is playing.

To the surprise of many, the U.S. and Japan recently agreed to begin exploring the possibility of a free trade agreement between the two nations. One reason for this discussion is certainly a fear of European protectionism after 1992, yet politics also plays a role. A precarious triangle has been formed between the EC, U.S., and Japan; with each side trying to balance the other two, both economically and politically, while maintaining a favorable position. By collaborating, it is most certain that the U.S. and Japan hope to increase pressure on the EC to truly remain open and competitive in the wake of 1992.

#### 6 EFTA Countries have Closest Links

Of all the countries previously discussed, it is the EFTA nations, (European Free Trade Association), that stand the most to gain, or to lose, from EC integration. EFTA and the EC are each others most important trading partners. In 1987, the EC accounted for over 60% of EFTA imports and took over 55% of EFTA exports. In the past few years, cooperation between the two organizations has greatly increased, culminating with the Luxembourg Declaration in 1984 which established the plan to create a European Economic Space (EES).

The goal of EES, is to integrate Western Europe directly, through the EFTA and EC organs, rather than by the previous method of bilateral trade agreements. Originally the EES was initiated by EFTA in reaction, (particularly by the neutral members), to the fear of economic misfortune and discrimination as the EC grew in size and power. The EES would allow EFTA nations to cooperate in the EC's integration process without being forced to actually join the Community. Yet once the EC began its internal market project in 1985, the EES gained impetus as the Commission too saw the value of further integrating Western Europe. For the EC, such a union, even if only economic, would help establish their new, more dominant international



role. The EES, which had previously been largely undefined, now became highly influenced by the EC's White Paper.

For the EFTA countries, the EES is very important as it will guarantee them access to the vast European market. Therefore, they are very concerned as to how the internal market emerges. Its accomplishments and setbacks will have a direct effect on EFTA nations. The EES includes not only free trade and open markets; but cooperation in such areas as transportation, technical standards, workers conditions, competition policy, and cultural issues. Much of the progress in these areas parallels the development of the EC's single market. Already many concrete agreements have been reached between the two European organizations. These include advance notification of technical standards and regulations; EFTA participation in European standardization bodies and research and development programs; lessening of border formalities; and increased transparency.

For EFTA, gains from the EES are similar to the gains the EC nations hope to receive from creating a single market. These include the general goals of opening markets, removing barriers, and expanding trade: thereby decreasing costs and increasing overall efficiency. The EES will also increase the international visibility of EFTA countries which have experienced a steady decline in world market share over the past two decades.

#### 7 EFTA too is Fearful of a Rise in Protectionism

However, despite the potential benefits; EFTA is concerned that the internal market may also have strong, negative repercussions. The largest problem for EFTA is that they are forced to mirror EC internal market directives without any input. The EC Commission has emphatically stated that the European Economic Space is their second priority - after the internal market. Therefore, to successfully complete the EES, the EFTA countries must be policy-takers. EFTA nations are forced to harmonize their legislation in such areas as competition policy, border controls, rules of origin, taxation, and public procurement; or be left behind.

The issue of open frontiers is a good example of the problems that harmonization could cause EFTA. If trade is allowed to flow freely across borders, then the EFTA nations must also adopt the EC tax structure. This includes not only tariff policy, but EC non-tariff barrier policy and its preferential agreements. This would be particularly difficult as EFTA has no uniform third-country policies, but rather allows each member to set their own.

EC-EFTA cooperation is also difficult for their legal structures are not compatible. The EC has empowered a Commission, a Parliament and a Court of Justice which are supposed to be the final word on EC policy. EFTA however, has no legislative body and has been more concerned with setting overall goals and objectives, allowing each member to settle their own disputes and policies on a bilateral basis. This again means that EFTA is forced to accept EC decisions if it wants to be a player.

EFTA's position is further weakened due to its heterogeneity. Its members have widely varied interests, policies, and goals. Some member countries seem to view EFTA merely as a convenient stepping stone until they can obtain admission into the EC. Norway is already a NATO member and most believe it is only a matter of time until it applies for full membership. Austria has also shown great interest in joining the EC. Over 60% of its exports and imports go to and from West Germany and it fears a significant loss in trade once the internal market is operational. However, it is hampered by its legal neutral status.

Neutrality is a key issue for many of the EFTA countries and is often their most unifying factor. In Finland, there is a strong feeling that neutrality and the EC are completely incompatible. Sweden however views Ireland as a precedent that contradicts this claim. Lastly, Switzerland, who has always preferred bilateral agreements, appears to regard EFTA as an unpleasant necessity. This diversity detracts from the potential leverage of a strong, cohesive unit, therefore diminishing EFTA's bargaining power.



The concerns of EFTA, that the internal market will bring protectionism and increased trade barriers, are no different than those of the rest of the world. Yet the EFTA predicament is particularly difficult for they are much more intertwined with the EC economies than anyone else. Due to their past relationship with the EC, they fear that the costs of 'non Europe' could be too high. This leaves EFTA countries with a troublesome option. Either they sacrifice their personal interests and neutrality and further integrate into the Community; or they must endure the possibility of trade diversion and discrimination as the walls around the EC climb higher.

#### 8 Are the Walls Climbing Higher?

Though the EC has strengthened substantially over the past years, the world is far too integrated for it to exert a completely independent influence. Therefore, plans for the internal market need to be continually evolving as world developments change. The 'Trade Triangle' between the EC, U.S., and Japan will play a crucial role as each player's actions will influence the others. Yet the EC Commission seems to be giving little concern to its future external relations, focusing only on the present internal process. It is only recently that they have even begun discussing any third country policy procedures, and still with no clear message.

To the rest of the world, this is a strong indication, that their worst fears could be realized, though in reality the outcome of 1992 is impossible to predict. Though their words deny it, many EC actions point towards an increase in trade barriers and discrimination. This has led other countries and trade blocs to begin discussing the formation of trade agreements among themselves. If the EC is not careful enough, they will not only encounter retaliation, but may find their flourishing internal market shut out of a cooperating international one.

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