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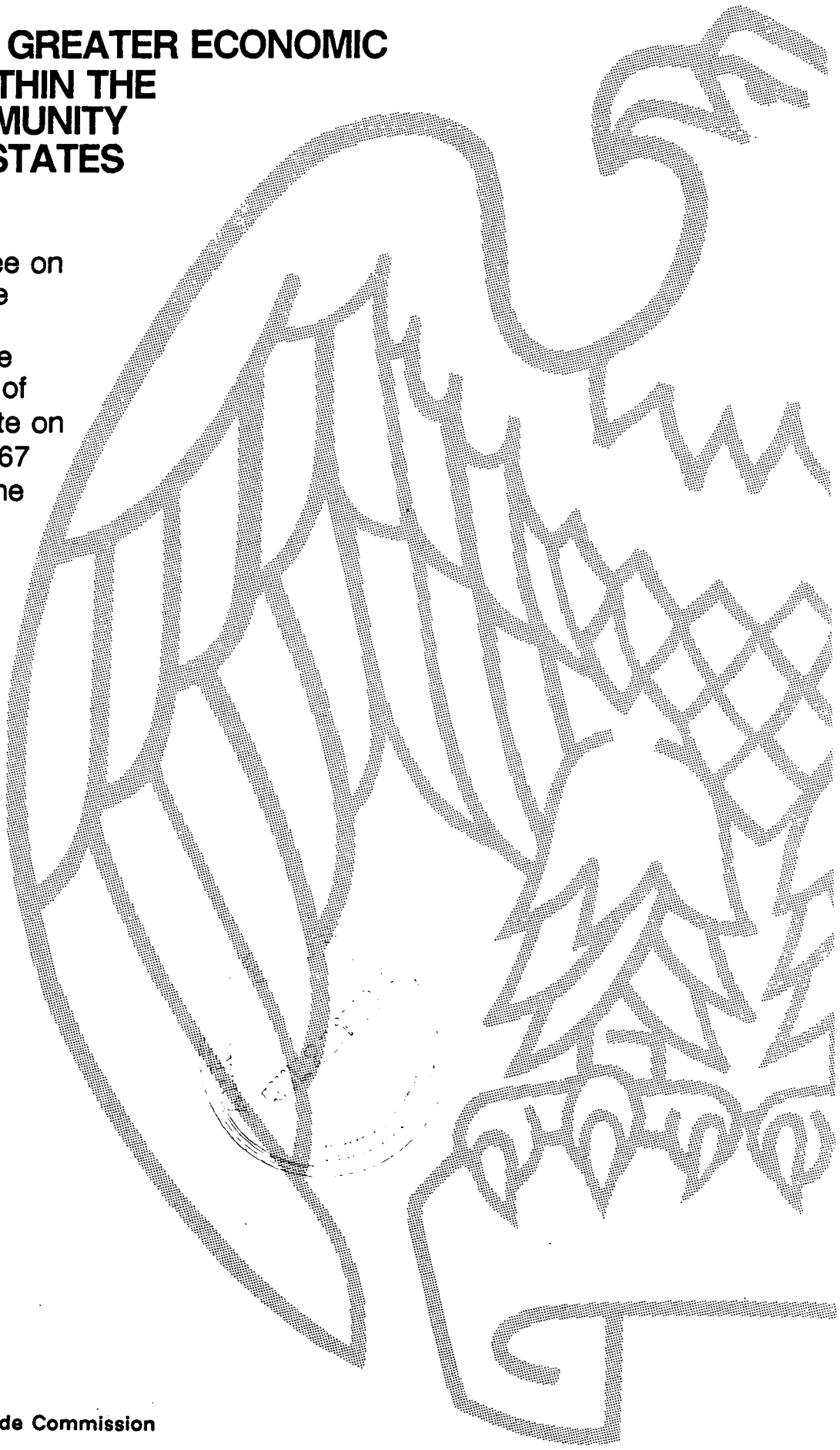

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PREFACE

On October 13, 1988, the United States International Trade Commission (USITC) received a letter[1] from the Committee on Ways and Means of the United States House of Representatives and the Committee on Finance of the United States Senate requesting advice pursuant to section 332(g) of the Tariff Act of 1930, with respect to the greater economic integration of the European Community (EC) scheduled to be in place by the end of 1992 and its possible impact on U.S. trade and investment and on U.S. business activities in Europe. In response to the request, the USITC instituted investigation No. 332-267 on December 15, 1988.

The committees noted that the form and content of the policies, laws, and directives removing economic barriers and restrictions and harmonizing practices among the EC member states may have a significant impact on U.S. business activities within Europe overall and in particular sectors. Further, the process of creating a single market may also affect progress and results in the ongoing Uruguay Round of GATT multilateral trade negotiations. Therefore, the committees requested that the USITC study focus particularly on the following aspects of the EC's 1992 program:

1. The anticipated changes in EC and member-state laws, regulations, policies, and practices that may affect U.S. exports to the EC and U.S. investment and business operating conditions in the EC.
2. The likely impact of such changes on major sectors of U.S. exports to the EC and on U.S. investment and business operating conditions in the EC.
3. The trade effects on third countries—particularly the United States—of particular elements of the EC's efforts.
4. The relationship and possible impact of the single-market exercise on the Uruguay Round of GATT multilateral trade negotiations.

Copies of the notice of investigation were posted at the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and the notice was published in the *Federal Register* (53 F.R. 51328) on December 21, 1988.[2]

A public hearing on the investigation was held on April 11, 1989, at the U.S. International Trade Commission building, 500 E Street SW., Washington, DC, and all persons who requested the opportunity were permitted to appear in person or by counsel. The USITC also collected data and information from secondary sources and conducted extensive overseas fieldwork.

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[1] See app. A.
[2] See app. B.

CONTENTS

Executive Summary

The European Community (EC), as it is known today, has developed from the merging of three original communities known as the European Coal and Steel Community (ECSC), the European Economic Community (EEC), and the European Atomic Energy Community (Euratom). The Treaty establishing a Single Council and a Single Commission of European Communities signed in 1965 effectively completed the formation of the EC.

Although the EC has had no internal duties and has had common external duties, internal as well as external trade has encountered numerous obstacles in the form of nontariff barriers. Some of these barriers developed over time as EC countries attempted to insulate particular industries and/or products after internal duties were eliminated. These measures were usually effective for the purposes devised, but they did have costs. Whereas the costs were tolerable in the 1950s and 1960s, they became more onerous in the late 1970s as most European economies slowed and a general "Eurosclerosis" (poor economic performance) developed that also adversely impacted the competitiveness of the EC nations in the world market.

Recognition of these costs and the desire to complete the internal market exercise, begun with the formation of the EC and the elimination of internal duties, were at least partially responsible for the White Paper issued by the EC Commission in June 1985. This White Paper contained broad goals for the integration program and set a date of 1992 for the completion of the program. Integration was to be completed by the elimination of barriers to trade in the physical, fiscal, and technical areas. This was to be accomplished through the issuance of approximately 280 "directives," each to correct one or more of the barriers to a free-trade internal market.

Organization of This Report

This report contains three sections. The first section contains introductory and background information on (a) the genesis of and prospects for the 1992 program, (b) the institutional framework and procedures for implementation of the 1992 program, (c) the descriptive and definitional aspects of the 1992 program, and (d) U.S. trade with the EC. This material is useful in gaining a better understanding of how the EC and its main bodies operate and how they relate to the EC 1992 program and its implementation. The second section contains a discussion and analysis of changes expected from the implementation of 254 directives issued prior to January 1, 1989, grouped into key categories.[1] This section is based upon a detailed review of each of the subject directives by "teams" of economists, international trade analysts, and lawyers.[2] The third and last section contains information and analysis of the reciprocity issue and the implications of the 1992 program for the GATT, the Uruguay Round, and other EC member-state obligations and commitments under bilateral or multilateral agreements and codes to which the United States is a party.

The principal highlights of the investigation are summarized below by report section.

Introduction and Background

Genesis of 1992 Program

- *A June 1985 White Paper issued by the EC Commission calls for the removal of barriers to the free movement of goods, services, people, and capital in the EC by December 31, 1992.*

The Treaty of Rome that created the European Community over 30 years ago envisaged that European prosperity depended on a single, integrated market. However, the momentum towards EC integration declined in the 1970s as stagnating growth and

[1] See app. C.
[2] See app. D for an index of industry/commodity analyses.

increased import competition raised domestic pressures for protectionist measures. Interest in EC integration revived in the early 1980s as concern grew over "Eurosclerosis," reduced European competitiveness, and the increasing inability of the EC institutions to function effectively and resolve problems. As a result, in June 1985 the EC Commission presented a White Paper on completing the internal market. This paper calls for the removal of all obstacles to the free movement of goods, people, services, and capital by December 31, 1992.

- *A new, more integrated EC will be emerging by 1992, even if some sensitive issues remain to be resolved.*

EC officials describe the single market program as "irreversible." However, they acknowledge that progress to date has been "patchy" and it is unlikely that all sensitive issues will have been resolved by the deadline. In general, support for the 1992 integration exercise remains strong within the EC, although individual member states have voiced concerns over relinquishing national sovereignty in certain sensitive areas. The EC Commission denies that protectionist measures against third countries will increase, as many non-EC nations fear, because of the EC's heavy reliance on world trade.

- *The four principal EC institutions each play a major role in the 1992 program.*

The EC acts through four principal institutions, each of which has a role in the 1992 program. The EC Commission proposes internal market measures and enforces EC law, the European Parliament reviews and comments on the proposed measures, the Council of Ministers approves and issues the measures, and the European Court of Justice adjudicates matters involving the EC treaties and EC law.

- *The Single European Act established the institutional framework of the 1992 program.*

The 1992 integration program is being accomplished according to institutional processes established in the Single European Act, which became effective on July 1, 1987. A new cooperation procedure for the EC institutions involves increased participation by Parliament and nonunanimous Council voting on most matters.

Review of Customs Union Theory and Research on the 1992 Program

- *The EC 1992 program will expand trade within the EC. However, customs union theory alone cannot predict whether trade with nonmember countries will increase or decrease.*

Reduction of internal trade barriers, pursuant to the 1992 integration program, will create trade among EC member countries at the expense of less efficient domestic producers. The internal trade liberalization, however, will also tend to increase trade among EC countries at the expense of existing trade with more efficient producers in the United States and other nonmember countries. Producers in nonmember countries will benefit if the EC 1992 program boosts growth in the EC.

- *Econometric models estimate that the EC 1992 program will increase EC gross domestic product by as much as 5.7 percent, create as many as 2.3 million jobs, and cut inflation, budget balances, and trade balances.*

The macroeconomic effects of 1992 estimated for the EC Commission using both the Interlink and Hermes econometric models include an increase in EC GDP of between 3.2 and 5.7 percent, a reduction of inflation of between 4.5 and 7.7 percentage points, and an easing of domestic budget balances and trade balances equivalent to between 1.5 and 3.0 percent of GDP and between 0.7 and 1.3 percent of GDP, respectively. It is also estimated that the labor market would improve, with the creation of between 1.3 million and 2.3 million jobs.

U.S. Trade with the European Community

- *The EC 1992 program could affect U.S. trade and the trade balance with the EC.*

The EC is the largest export market for the United States and is second only to Japan as a source of U.S. imports.

- *U.S. exports to the EC amounted to $71 billion in 1988, or 23 percent of all U.S. exports.*

In 1987, U.S. exports represented about 7 percent of all EC imports. The largest U.S. export product categories to the EC in 1988 were office machines, computers, and typewriters (SITC division 75), $10.5 billion; other transport equipment (division 79), $6.4 billion; electrical machinery, apparatus, and appliances (division 77), $4.5 billion; power generating machinery and equipment (division 71), $4.1 billion; and professional and scientific controlling instruments and apparatus (division 87), $3.0 billion.

- *U.S. imports from the EC amounted to $84 billion in 1988, or 19 percent of all U.S. imports.*

U.S. imports from the EC in 1987 represented about 9 percent of all EC exports. The two largest import product categories from the EC in 1988 were road vehicles (SITC division 78), $11.2 billion; and machinery specialized for particular industries (division 72), $6.2 billion.

- *The EC trade balance with the rest of the world increased from a negative $26 billion in 1984 to a positive $1 billion in 1987.*

About 58 percent of EC trade in 1987 was internal among the member countries. West Germany, France, and the United Kingdom were the principal participants in this intra-EC trade. In 1987, the United States was the principal trading partner with the EC in its external trade. In that year, the United States purchased 21 percent of EC exports to external markets and provided 16 percent of EC imports from external sources.

- *There is a trend of decreasing EC dependence on external markets and sources.*

The slow but steady increase in EC internal trade from 53 percent of total trade in 1984 to 58 percent in 1987 emphasizes the increasing independence of the EC from external markets and sources for goods. EC harmonization may further this trend.

Anticipated Changes in the EC and Potential Effects on the United States

Government Procurement

- *Governments in Europe are large and potentially crucial markets.*

Public purchasers already account for about 90 percent of U.S. telecommunications equipment sales in the EC and one-third of the sales by major U.S. computer and office machine manufacturers. Public procurement in the EC amounted to more than $350 billion in 1987, with the United Kingdom, West Germany, France, and Italy being the largest markets.

- *U.S. suppliers do not have ensured access to nearly half of this procurement because it has been removed from the scope of EC and international rules intended to ensure fair treatment of foreign suppliers.*

Even where such rules exist, progress in opening up public sector opportunities in the EC has been minimal. On average, EC members procure less than 2 percent of government needs from nonnational suppliers, including those from other EC members; 75 percent are awarded to "national champions" for whom the tenders are tailor made.

- *As part of the 1992 program, the EC has proposed 5 directives to combat discrimination in public procurement, and 2 others are reportedly under preparation.*

The aim of these directives is to (1) close loopholes in existing directives; (2) expand coverage to services contracts and entities in the so-called "excluded sectors" of water, energy, transport, and telecommunications; and (3) put in place effective enforcement mechanisms.

- *The EC's new rules could encourage more open procurement by entities at all levels in the member states.*

Many of the changes proposed are responsive to previous U.S. requests made in the context of the GATT Government Procurement Code. The key question will be how these directives are implemented and whether the EC's proposed enforcement mechanisms prove adequate to the task.

- *U.S. business is concerned about a proposed 50-percent EC value-added rule for procurement related to water, energy, transport, and telecommunications.*

The 50-percent EC value-added rule is apparently less stringent than local-content requirements applied informally now by member states, but U.S. firms fear it may open the door for abuses of administrative discretion by procuring officials, limit flexibility, and increase uncertainty.

- *Some U.S. suppliers are already being asked to raise the EC content of their products in order to keep existing contracts with EC public purchasers.*

U.S. firms reportedly are pursuing direct investments and joint ventures with EC companies to assure their meeting 50-percent EC value-added. This investment is also supported by higher growth expectations in the public sector markets in the 12 member states.

Financial Sector

- *The 1992 program for financial services has raised interest and concern in the United States.*

U.S. firms are aware that EC capital markets and financial firms are likely to become relatively more competitive and efficient. Liberalized and open financial and capital markets in the European Community may create potential business opportunities for U.S. financial services firms that are operating in the EC or that establish operations there in the future. U.S. firms are unsure, however, of how the European Community and the individual member states will implement the 1992 program. Reciprocity provisions have been incorporated in the financial services directives, and U.S. firms are concerned about whether their adoption and implementation will either directly or indirectly restrict existing or future business activity by U.S. firms.

- *The original proposal for a Second Banking Directive, which was issued in February 1988, contained a reciprocity provision that raised significant concern in the European Community and in third countries.*

The reciprocity provision would have made the entry of third-country banks into the single market dependent on whether all EC banks received "reciprocal treatment" (however defined) in the third country concerned. The proposal included an automatic suspension-and-review procedure that even applied to third countries that granted "reciprocal treatment." U.S. firms were concerned that the EC Commission might have determined that the United States does not provide "reciprocal treatment" because the United States legally separates commercial and investment banking and legally restricts interstate banking, whereas the 1992 program allows universal and interstate banking.

- *In April 1989, the EC Commission replaced the reciprocity test with a more flexible procedure.*

The amended proposal provides that the European Community would expect EC banks to receive "comparable effective market access" and "comparable competitive

opportunities" in third countries. The European Community may seek such comparable treatment (however defined) through negotiations with the third country concerned. The amended provision does not deal with sanctions in the event that such negotiations fail. However, if EC banks do not receive genuine national treatment, as interpreted by the EC Commission, then the EC could suspend requests for banking licenses. Under the amended proposal, the European Community may seek to negotiate with the United States in order to obtain comparable treatment, and requests for banking licenses by U.S. banks could be suspended if the EC found that the United States does not grant genuine national treatment as defined and interpreted by the EC Commission.

- *At a meeting on June 19, the EC Council reportedly largely accepted the EC Commission's amended proposal and reached a common position in principle on the Second Banking Directive.*

The discussion at the EC Council centered mainly on the procedure that would apply to third-country bank applications and whether the EC Commission or the EC Council would have final responsibility for overseeing the procedure. In an apparent compromise, the EC Council was reportedly given greater responsibility for reviewing third-country banking applications. Once a final common position is reached, the directive could be adopted. The European Community has reportedly indicated that its treatment of third-country firms in the investment services and insurance sectors may follow the more flexible approach taken in the banking sector, although there has been no formal linkage.

- *The 1992 program for the financial services sector may be understood as a response to the rapid globalization of world financial markets.*

The frequent introduction of new and hybrid financial instruments, along with the structural and institutional changes occurring in the investment banking and commercial banking sectors, has highlighted the need for greater cooperation between regulatory authorities within the same national market and in different countries. The 1992 program responds to these developments and is intended to accelerate the trend toward relying on the efficiencies of global market forces in the European Community.

- *The 1992 program for financial services creates potential opportunities for U.S. firms.*

The financial sector directives have the potential to create trade opportunities for U.S. firms that provide financial and insurance services in the EC. The directives should expand trading opportunities for U.S.-owned banks, securities firms, and mutual funds principally because they provide for the elimination of restrictions on the movement of capital and the overall deregulation of EC financial markets. The directives also hold potential for U.S. financial services firms (banks, securities firms, mutual funds, and insurance companies) with subsidiaries in the EC. In addition, the second nonlife (property and casualty) insurance directive provides U.S.-based insurance companies with operations in one member state the potential to market their services to all EC countries. The financial sector directives are, for the most part, likely to encourage U.S. investment in the EC and enhance operating conditions in the EC for U.S. financial services firms and insurance companies.

- *The 1992 program also creates potential challenges for U.S. firms.*

In addition to the reciprocity issue, another important risk is the challenge posed by the prospect of EC financial firms becoming more competitive and operating in a larger and more efficient financial and capital market.

Standards

- *Standards harmonization is a key component of the 1992 program.*

Of the 300 or so initiatives originally programmed in the 1985 White Paper, more than half—a total of 175—are standards related. The number of products affected is potentially enormous.

- *The stakes for the United States are substantial.*

Important U.S. export industries—such as autos, computers, chemicals, telecommunications, medical equipment, and other machinery—will be fundamentally affected by actions taken as part of the 1992 program. These industries alone represented more than $40 billion in U.S. exports to the EC in 1988. In a recent report, the U.S. Department of Commerce has established that 21,900 jobs are associated with each $1 billion in U.S. manufactured exports.

- *Almost 40 percent of the standards directives are concerned with various aspects of agriculture.*

Most national and EC standards on additives and other food-product characteristics are developed by respective governments and the EC. Such agricultural standards are often made mandatory by passage of national or EC regulations. As a result, the process of issuing such rules has been made slow and the harmonization of EC standards for agriculture remains incomplete.

- *The EC's goal is to eliminate technical barriers within the European Community.*

Elimination of technical barriers would allow a product marketed in one member state to be traded freely throughout the EC, thus eliminating the need to undertake duplicative standards-related testing, approval, and inspection.

- *Removal of such barriers, by adoption of uniform standards, could facilitate U.S. sales.*

Some U.S. industries, such as telecommunications and pharmaceuticals, expect to benefit as a result of the EC's actions. Divergent standards among the EC member states have held back the competitive potential of U.S. suppliers.

If the EC's new standards are biased against U.S. suppliers, however, U.S. firms could see an erosion of their competitive position and a drop in actual sales levels, as time is lost retooling production lines and securing needed clearances and approvals.

- *More than $9.3 billion in U.S. exports may be adversely affected as a result of the 13 areas of EC directives analyzed in detail. Many of the remaining directives reviewed do not appear to pose a problem for U.S. interests.*

U.S. suppliers of broadcasting services, meat, tractors, forklift trucks, and lawnmowers stand to lose significantly if currently proposed EC directives are not changed.

- *Nearly all U.S. exporters complain that they have limited access to the EC's standardsmaking process.*

U.S. firms with direct investments in the EC have had somewhat better access than those without. The United States does not participate in the European standardsmaking bodies and has no formal means of commenting on drafts developed by them. Since EC suppliers do participate, they are in a position to influence their content and to take steps earlier to adapt their product lines. Moreover, EC policy on testing and certification may place U.S. suppliers at a disadvantage.

- *Many U.S. firms are investing directly in the EC.*

Direct investment will ensure that U.S. firms will be poised to benefit from increased intra-EC trade—even if the new standards and certification procedures impede U.S. exports.

Customs Controls

- *The abolition of internal customs procedures is expected to facilitate trade in goods by member-state and third-country firms alike.*

The directives falling under the general description "customs" deal with three areas: freedom of movement for goods, freedom of movement for persons, and general

guarantees of workplace health and safety. To achieve completely free movement of goods among member states, customs border checks are to be eliminated and replaced by uniform, detailed procedures at the EC's external frontiers. Because the new customs regime would involve a major shift of authority to the EC level, many of these measures have not yet been approved. Among U.S. interested parties, U.S. firms established in EC or European Free Trade Association (EFTA) countries should experience the largest reduction in costs and delays.

- *In the past a national of a member state has been accorded guarantees of free movement to and residence in other member states only in the context of the performance of work and services.*

It has been impossible to practice most professions or trades in countries other than one's own. Under the EC Commission's proposals, any EC national would be able to move freely into and take up residence in any member state, upon a showing of financial self-sufficiency, and could be accompanied by family members. Moreover, while work to harmonize professional training standards continues, all higher education diplomas, professional degrees, and vocation-related certificates of training obtained in a member state would be recognized in the others, and holders thereof could practice their trades or professions in any other member state on terms applicable to that country's nationals. It is not expected that these changes would have significant effects on U.S. interests, because they involve only EC nationals; but U.S. entities would have more flexibility in hiring and transferring such persons.

- *The EC Commission's new responsibility for banning dangerous substances from places of work may result in additional costs or new production methods for both EC and foreign firms.*

The EC institutions would assume responsibility for setting generally applicable standards of safety and health for all places of work in the EC. Such criteria would apply not only to industrial facilities but also to cultural establishments, schools, government buildings, offices, shops, and other worksites (except foreign embassies). It is believed that U.S. companies established in the EC generally meet or exceed the new standards, but some changes may be needed in nonmanufacturing facilities.

Transport

- *Transport directives are designed to introduce competition into the air, water, road, and passenger transport industries within the EC.*

These directives do not deal directly with third-party rights covered under existing bilateral agreements, and uniform implementation of the directives by individual member states may not be achieved.

- *Transport receipts account for more than 7 percent of the EC gross domestic product.*

Without the orderly movement of goods and services across the boundaries of member states, manufacturing efficiencies expected from integration may not be achieved. For example, a 750-mile trip through the EC by truck takes an estimated 63 hours to complete. Considerable paperwork is required at border crossings, particularly with respect to value-added taxes.

- *A decision by the European Court of Justice in 1986 held that the rules of competition under the Treaty of Rome were applicable to air transport.*

Following that decision in December 1987, the EC Council applied the Treaty of Rome's competition rules to pricing, access to routes, and capacity sharing. Under these competitive rules, air fares will receive automatic government approval provided fares are set within certain limits.

- *Major concerns of the U.S. transport industry relate to how existing bilateral agreements with member states in the EC will be affected.*

The industry fears that after integration, the member states may decide to bargain as a unit over cabotage, the right to transport passengers between local markets. National

carriers may argue that permission for U.S. carriers to transport passengers between cities in the member states should depend on reciprocal rights in the U.S. market.

- *The U.S. air transport industry, as well as the European industry, may be unable to expand investment and services in the EC because of congestion, physical limits, and high costs associated with providing these services.*

Growth and lower passenger fares expected from the deregulation of air transport services in the EC may be limited by the existing congestion, crowded airspace, and inefficient use of aircraft and personnel. The Association of European Airlines has called for an overhaul of the European air traffic control system, which consists of more than 40 separate control centers.

- *Overall, the transport directives should provide investment and marketing opportunities for U.S. transport-service providers.*

U.S. service providers have benefitted from serving the deregulated markets in the United States and can offer competitive services in the open and deregulated markets in the EC after 1992.

Competition and Corporate Structure

- *The corporate business atmosphere in Europe is changing for subsidiaries of U.S. companies doing business in Europe through the EC Commission's efforts to create a European Community antitrust policy and to harmonize the member states' company laws.*

Most U.S. companies investing abroad are believed to be large multinationals whose post-1992 merger and acquisition activities could come under review by the EC Commission as a result of the regulation on the control of concentrations in an industry (88/734). U.S. companies seem to be responding to the European initiative by restructuring prior to 1992.

- *U.S. exports could be affected positively or negatively, depending on the direction taken by the EC on mergers and acquisitions after 1992.*

While uncertainty still exists as to the final direction to be taken by the EC in the area of merger policy, the general consensus seems to be that the overall effect of this regulation will be trade neutral.

- *U.S. firms could benefit from the opening of the telecommunications end-use terminal equipment market.*

The EC is not only the largest market for U.S. exports of telephone and telegraph equipment, but U.S. exports to that market have increased steadily in the past 4 years. The opening of the EC telecommunications market could further stimulate these U.S. exports.

- *The harmonization of company law is likely to have a positive effect on U.S. companies doing business in Europe.*

Learning and adapting to 12 different legal systems will no longer be necessary. These directives affecting the business environment in Europe will probably be neutral or positive for all companies doing business in Europe, including U.S. subsidiaries.

Taxation

- *To date, the EC has focused principally on two areas of tax harmonization—(1) approximation of indirect taxes, such as the value-added tax (VAT) and excise duties, and (2) establishment of a common system of withholding tax on interest income.*

The former relates to the need to approximate indirect taxes if border frontiers are to be removed, and the latter relates to efforts to create a common market in financial services. In August 1987, the EC Commission issued a comprehensive fiscal package,

including seven proposed directives, covering VAT and excise duties, and in January 1989 issued a proposed directive on a common system of withholding tax on interest income.

The key measure on VAT would require that all member states impose a dual-rate VAT system, standardize the goods and services subject to each rate, and set rates at a level within specified rate bands. The measures relating to excise taxes cover alcoholic beverages, tobacco products, and mineral oils (e.g., gasoline and diesel). The measure related to a withholding tax on interest income is intended to lessen the possibility of capital flow distortions and tax evasion when EC residents become free to transfer their savings into bank accounts in any other member state. Among other things, this measure would require that all member states impose a minimum withholding rate of 15 percent on interest income.

- According to *the EC Commission's Fourth Progress Report in May 1989, taxation is one of the four areas furthest behind schedule.*

Present rates and methods of imposing VAT and excise duties differ considerably among member states. Implementation of the proposed VAT directives will significantly impact revenues and will affect social policy in several countries. For example, the United Kingdom and Ireland, which presently do not impose VAT on foodstuffs and other necessities, would thus be required to do so. Denmark, which is the highest tax member state, would be required to reduce rates and would thus lose substantial revenues. The withholding tax measure is strongly opposed by the United Kingdom, Luxembourg, and West Germany and is considered unlikely to be adopted in its present form. In May 1989, the EC Commission suggested a new approach to resolving member-state concerns about the proposed VAT and excise directives and in July 1989 issued suggestions relating to concerns about the proposed withholding tax directive.

- *In general, it is unlikely that the tax proposals, with the possible exception of the proposal affecting manufactured tobacco, will have a significant impact on U.S. exports to the EC or on total EC imports.*

With respect to the proposed directive that would harmonize VAT rates into standard and reduced bands, any marginal impact the adoption of this directive may have on U.S. exports of any particular commodity will be largely determined by the difference between each member state's current VAT rate for the commodity and the new VAT rate for the commodity within the two proposed brackets. However, U.S. exporters of manufactured tobacco products are concerned that higher ad valorem taxes on such products may discriminate in favor of lower priced EC products. Although the proposed directives, per se, are not expected to become a determining factor in investment decisions if adopted, they could have a positive impact on U.S. investment and operating conditions in the EC by simplifying tax rates and structures and by reducing costs associated with the movement of goods across member-state borders.

Residual Quantitative Restrictions

- *The elimination of intraborder controls will pressure the EC Commission to transform existing, or residual, national quantitative restrictions (QRs) into EC-wide quotas or other protective measures, particularly in sensitive sectors.*

Although the new EC-wide quotas are considered likely to be directed at Asian exporters rather than exports from the United States, they could intensify trade-diversionary effects, increase competition facing U.S. exporters in certain member-state markets, or increase competition for U.S. subsidiaries already located in the EC.

- *Currently individual EC member states impose over 1,000 QRs, which are safeguarded by article 115 of the Treaty of Rome.*

Because these national QRs will be inconsistent with the integrated single market, the EC has indicated that it intends to abolish all member-state QRs and article 115 by 1992.

- *The EC may unilaterally abandon existing national QRs or replace them with EC-wide measures, including EC-wide quotas, increased reliance on antidumping statutes, or subsidies.*

Although the EC Commission has not issued any regulations or directives addressing national QRs, it has begun to negotiate the elimination of some of these QRs and has indicated some of the options it intends to pursue for the remaining quotas. The choice of options, among other things, will be determined by the sensitivity of the sector, as well as whether trade problems are considered EC-wide in dimension.

- *Three sensitive sectors—automobiles, footwear, and textiles and apparel—are considered most likely to be subject to EC-wide QRs after 1992.*

Because QRs on imports of steel are already applied on a primarily EC-wide basis, no changes in the EC's steel import regime are anticipated.

- *EC-wide quotas on automobiles, footwear, and textiles and apparel are considered likely to be directed at Far Eastern exporters rather than at U.S. exporters.*

In footwear and textiles and apparel, a shift to EC-wide quotas could cause controlled suppliers to redirect shipments to markets where they have the greatest competitive advantage, but which had been limited by a member state QR, thereby increasing competition for U.S. exports in these markets. EC-wide QRs in footwear could also cause trade diversion to the United States. In the automobile sector, non-EC companies that face QRs on their automobile exports are expected to increase investment in production facilities within the EC, thereby increasing competition for U.S. firms already operating in the EC. EC-wide quotas directed at Japan could also increase marketing opportunities for U.S. exports in the EC. However, if the EC institutes local content requirements on automobiles, Japanese-owned automakers in the United States could face barriers in exporting to the EC.

Intellectual Property

- *The issue of intellectual property rights in the EC is an important one for the United States.*

Many U.S. products sold in the EC are or can be protected by some intellectual property right. Such rights are especially important for firms selling high-technology products such as biotechnology and computer software, because of the considerable investment often required to develop such products (e.g., biotechnology) and/or the ease in copying such products (e.g., computer software).

The EC has adopted or proposed directives or regulations (1) to establish EC-wide regimes for semiconductor topographies ("mask works") and trademarks and (2) to harmonize existing member states' regimes with respect to trademarks and patents for biotechnological inventions. The EC has also issued a Green Paper (consultative document) to address several copyright issues. More recently, the EC has proposed a directive on computer programs.

- *Enhanced or standardized intellectual property regimes will benefit U.S. commercial interests in the EC.*

In general, the EC's adopted or proposed establishment and harmonization of intellectual property regimes will enhance or standardize intellectual property protection in the EC. Such enhancement or standardization will generally benefit U.S. commercial interests in the EC.

Implications of EC Market Integration for GATT and Other International Commitments

Reciprocity

- *The European Community has incorporated reciprocity clauses into several proposed directives.*

The U.S. Government and U.S. business sources oppose reciprocity clauses because they feel that these provisions could lead to discrimination against U.S. firms. Also, the

EC has suggested that it will take reciprocity into consideration as it implements other measures to liberalize trade with respect to third countries in sectors not subject to the GATT. However, the U.S. Government believes that reciprocity is inconsistent with the principles of national treatment and nondiscrimination upon which international commercial relations are based.

- *The concept of reciprocity was not initially defined by the EC Commission.*

The original term "reciprocal treatment" was not clearly defined and could mean anything from an identical regulatory and operating framework to nondiscrimination. For example, if the EC required market opportunities abroad that were identical to those in the single EC market as a condition for establishment of third-country firms, U.S. banks and insurance companies could be denied entry to the EC market. However, an October 1988 EC press release and the amended proposed reciprocity language somewhat clarified EC intentions and diminished U.S. concerns correspondingly.

- *Reciprocity continues to undergo revision.*

In 1988, the EC indicated that access of third-country firms to EC banking, financial services, and life insurance markets would be contingent upon EC firms receiving "reciprocal treatment" from the non-EC firms' home countries.

The May 1989 amended proposed reciprocity provision with regard to banking calls for "effective market access" and competitive opportunities in a third country comparable to those granted by the EC to credit institutions of that country.

In June 1989, the Council of Ministers reportedly agreed, in principle, to a revision of reciprocity that would increase Council control over the interpretation and implementation of reciprocity.

- *EC officials state that reciprocity is envisioned as a tool to liberalize foreign markets rather than to "protect" the EC.*

Sources suggest that Japan is the target of EC reciprocity provisions. In addition, EC officials state that they do not feel that the United States discriminates against EC financial services firms. Further, the EC asserts that its reciprocity clauses do not and will not breach any agreement to which the EC is a party.

- *U.S. Government and business leaders continue to lobby to protect U.S. interests that may be threatened by EC reciprocity provisions.*

Specifically, U.S. firms already established in the EC are concerned that their rights have not been recognized in the amended proposal; however, the June 1989 revision reportedly addresses this concern. Other aspects of the reciprocity provisions also remain unclear. Finally, the U.S. Government is particularly concerned that the adoption of a policy of reciprocity could impede the progress of liberalization in ongoing and future multilateral trade negotiations. Also, the EC Commission has said that it will seek reciprocity as a condition in the opening up of public sector procurement.

EC Integration and the GATT

- *The United States and other countries are concerned that the EC program might result in increased protectionism or in discrimination against their exports to the EC.*

As a contracting party to the GATT and a signatory to all of the Tokyo Round codes, the EC has agreed to be bound by these multilateral rules.

- *U.S. trade interests affected by EC 92 could be addressed in GATT in the Uruguay Round.*

If practices that adversely affect U.S. trade interests arise out of EC integration or are believed to violate GATT rules, the GATT and the Uruguay Round are two channels the United States can use to complement bilateral efforts to address its concerns. For example, the United States recently employed multilateral dispute-settlement provisions

to address one EC directive now in force—the U.S. engaged in bilateral consultations under the GATT Standards Code regarding aspects of the EC Hormone Directive.

- *GATT working parties set up to evaluate customs unions and free-trade areas have often avoided making definitive conclusions about the consistency of the arrangements with GATT rules or have neglected to make findings regarding adverse effects on trading partners.*

Such was the case at the formation of the EC customs union at a time when U.S. interests favored a stronger Europe and U.S. trade deficits had not developed. After considering the Treaty of Rome, which established the EC common market, the GATT contracting parties were unable to agree to a finding on the compatibility of the treaty with GATT rules. In addition, inconclusive EC negotiations on trade compensation to non-EC countries were sidetracked and eventually dropped.

EC Integration and the Uruguay Round

- *One concern regarding the impact of EC 1992 on the Uruguay Round is that a number of internal policies and directives may already be established when related issues arise in the Uruguay Round.*

The EC effort and the Uruguay Round are occurring side by side. The Uruguay Round is scheduled to be completed by the end of 1990—earlier than the EC internal market exercise. Nevertheless, the EC has already passed many of the new directives. EC member states will have reached carefully crafted compromises on the internal matters. To the extent that the EC policies support U.S. positions and an evolving consensus among Uruguay Round participants, the EC could be a constructive player. However, if the direction of Uruguay Round negotiations were to diverge from the already-established EC internal decisions, the EC might have little negotiating flexibility.

- *The EC may want to claim "credit" or compensation in the Uruguay Round for any liberalizing effects of EC market integration accomplished as part of the 1992 program.*

The EC's trading partners fear that the EC may resort to discrimination or reciprocity if such credit is not forthcoming. Such a position by the EC could frustrate chances to achieve the objectives of the round.

- *In "new areas" not currently subject to GATT (e.g., services and investment), the impact of EC 1992 initiatives and the interplay between these and the Uruguay Round is the most unpredictable.*

For example, GATT trade ministers agreed at the midterm review in Montreal on the principles that would be included in a framework of rules covering trade in services. They mentioned transparency, national treatment, most-favored-nation treatment, and nondiscrimination. However, some proposed EC directives and policy statements indicate that the EC may seek reciprocity instead of national treatment from trading partners in exchange for benefits of internal liberalization in service sectors such as banking.

EC Integration and Other EC Commitments

- *A reciprocity requirement could place individual EC member states in violation of provisions of the OECD Capital Movements Code.*

The OECD Capital Movements Code sets forth the goal of dismantling barriers to capital movements among contracting parties, which include the United States and all 12 member states of the EC.

- *A reciprocity requirement could conflict with the principle of national treatment embodied in friendship, commerce, and navigation treaties.*

Friendship, commerce, and navigation treaties to which the United States and EC member states are parties generally provide for national treatment and MFN treatment for U.S. goods and investment in the EC.

PART I
INTRODUCTION AND BACKGROUND

CHAPTER 1
GENESIS OF THE 1992 PROGRAM

CONTENTS

Chapter 1

Genesis of 1992 Program

Background and Outlook for EC 1992

Over 30 years have passed since the EC was created under the Treaty of Rome. After three decades of alternating periods of growth and stagnation, and trade liberalization and protectionism, the EC has embarked on an ambitious program designed to stimulate growth and international competitiveness through further integration of the EC's internal market. The goal of the program is to remove all barriers to the free movement of goods, services, capital, and people among the 12 EC member nations by yearend 1992. December 31, 1988, marked the halfway point in the program. EC officials now hail the single market process as "irreversible," although progress to date has been "patchy."

Historical Background

The 1992 single-market program was formally initiated in 1985 with the publication of an EC Commission White Paper entitled "Completing the Internal Market." However, as the formal title of the project implies, this program is part of a much longer historical process aimed at creating a single European economy based on a common market. The foundation for this historical process lies in the founding treaty of the EC.

In postwar Europe, the emergence of two new world superpowers changed the balance of political and military power.[1] At the same time, it was considered important to integrate West Germany both politically and economically into a European group in order to promote economic recovery and political stability, and reduce the likelihood of future warfare. These concerns over preserving and strengthening peace, combined with the devastation from World War II, motivated many Europeans to seek a united Europe, in the military and political sphere as well as for economic reasons. The form this cooperation should take soon divided Europeans into two camps: those favoring a federal system and those supporting looser intergovernmental cooperation that would not infringe on national sovereignty. These two sides laid the foundations for two institutions we see today: the EC and the European Free Trade Association (EFTA).

The first major step towards a European community occurred on April 18, 1951, with the founding of the European Coal and Steel Community (ECSC). Although the economic integration was limited to two sectors, the ECSC was remarkable because it was established to operate independently of the national governments of the six founding countries (France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg). The success of the ECSC prompted officials from the six member nations to consider further economic integration. In addition, they viewed integration as a possible means towards reversing the postwar trend showing Europe's waning influence in world affairs.

On March 25, 1957, two treaties were signed in Rome: one establishing a European Economic Community (EEC) and another creating the European Atomic Energy Community (Euratom).[2] Both the EEC and Euratom entered into effect on January 1, 1958. Together with the ECSC, they formed the European Communities. It is now common practice, however, to refer to any or all of the European Communities as simply the European Community.

The Treaty of Rome that established the EEC envisaged that European prosperity depended on a single, integrated market. The immediate goal was the formation of a customs union, which encompassed the removal of all obstacles to the free movement of goods, persons, services, and capital between the member countries. The customs union also resulted in the adoption of a common customs tariff (common external tariff) on imports into the EC by harmonizing national customs duties on non-EEC goods and eliminating duties on intra-Community shipments. In addition, the Rome treaty recognized that the four basic freedoms had to be supported by related policies, such as harmonization of member-state economic policies and application of common measures in such areas as agriculture, transport, antitrust law, and external trade. Although the treaties establishing the EC were restricted to the economic sphere, they resolved to move toward the political goal of "laying the foundations of an ever closer union among the peoples of Europe."[3] To guarantee progress toward political union, the treaties endowed their institutions with certain supranational powers, independent of, yet collectively controlled by, the member countries.

The first major focus of the Rome treaty was the gradual removal of all tariffs and quotas between the EC member nations and the introduction of a common customs tariff within a 12-year transition period. On July 1, 1968, 18 months earlier than planned, the remaining industrial tariffs between the six member countries were abolished and the common

[1] For a history of the origins of the EC, see among other sources, "European Unification: The origins and growth of the European Community," European Documentation, 2/1987.

[2] The purpose of Euratom is to coordinate and encourage the development of nuclear energy for peaceful purposes.

[3] Preamble of the Treaty of Rome. See "European Unification: The origins and growth of the European Community," European Documentation, 2/1987, p. 22.

external tariff entered into force, thus completing the customs union. The customs union led to rapid growth in intra-EC trade and prosperity in most member countries. However, severe oil-price fluctuations, among other things, contributed to a general decline in the economies of the member countries in the 1970s. The recession of the early 1980s compounded these problems and brought confidence in the EC to an all-time low. Europeans coined a term for the indifferent performance of the EC economy—Eurosclerosis.[4]

The Treaty of Rome required not only the abolition of customs duties between member countries, but also the elimination of quantitative restrictions and of all measures having an equivalent effect. However, stagnating growth and increased import competition raised domestic pressures for protectionist measures. Member countries introduced nontariff barriers against each other as well as third countries and requested public aid to protect and maintain uncompetitive industries. The momentum towards further EC integration declined substantially.

Interest in EC integration revived as many European industries became less and less competitive with industries in the United States and, in particular, Japan and the newly industrialized countries of the Far East. Concerns were expressed over the higher unemployment and lower per capita GDP in the EC compared with its two major competitors. EC industries signaled a need for further integration as they fell behind in research and development, innovation, and competitiveness. Between 1979 and 1985, the share of EC exports of industrial goods (excluding intra-EC trade) in the exports of all OECD nations declined by 1.4 percent, compared with an increase of 0.7 percent for the United States and 5.4 percent for Japan.[5]

Launching 1992

Eurosclerosis, reduced European competitiveness, and the increasing inability of the EC institutions to function effectively and resolve problems[6] led member governments to conclude that increased cooperation would be necessary to increase economic efficiency and competitiveness.[7] At a summit meeting in Copenhagen in 1982, the European Council (composed of the heads of government of the member states) announced that completion of the internal market was a priority issue. In March 1985 at the Brussels Summit, the European Council requested the EC Commission to propose a specific timetable for completing the internal market. As a result, the new commission, which began its 4-year term of office in January 1985, published a White Paper on "Completing the Internal Market" in June 1985. The White Paper is a detailed plan for the removal of all obstacles to the free movement of goods, people, services, and capital by 1992. It presents a specific timetable for implementing some 300 separate measures or directives that would abolish all physical, technical, and fiscal barriers to trade. The deadline of December 31, 1992, was selected to coincide with the end of the next EC Commission's 4-year term, thus providing for completion of the internal market within two EC Commission terms, or a period of 8 years altogether.

Vital to the success of the 1992 project was the passage of the Single European Act, which changed the voting procedures established under the Treaty of Rome. Instead of unanimity in Council voting, the Single Act allows certain decisions relating to the internal market exercise to be made by a qualified majority. Approximately two-thirds of the internal market directives are included, with the exceptions falling in the areas of taxation, professional qualifications, and the rights and interests of employees. The act became effective on July 1, 1987, and represented the final critical step in the launching of the internal market program.[8]

Outlook for 1992

In general, support for the 1992 exercise remains strong within the EC. Solid endorsement from business and government leaders continues. However, certain institutional mechanisms may delay or block progress toward the 1992 goal. For example, coordination among the various councils of ministers charged with implementing the program (e.g., internal market, agriculture, finance, transport, etc.) may prove difficult given that political interest in the White Paper varies

[4] See, for example, Jacques Pelkmans and Alan Winters, *Europe's Domestic Market* (London: The Royal Institute of International Affairs, [1988]), p. 2, or Jacques Pelkmans, "An Enterprising Community: The Common Market as Locomotive for Integration," *SAIS Review*, January 1988, pp. 138, 139.

[5] *European Economy*, No. 34, November 1987, p. 49.

[6] For a discussion of the frustrating inaction within the EC, see Jacques Pelkmans, "A Grand Design by the Piece? An Appraisal of the Internal Market Strategy," *1992: One European Market?* The European Policy Unit at the European University Institute, Florence, 1988.

[7] See, for example, Amy Skolnik, "The EC Internal Market: An 'Economic United States' of Europe?" Bank of Finland Economics Department, 1988, pp. 8, 9, or Michael Calingaert, *The 1992 Challenge From Europe: Development of the European Community's Internal Market* (Washington, DC: National Planning Association, [1988]), pp. 7, 8.

[8] For further information on the Single European Act, see "Institutional Mechanism for the 1992 Program" below.

greatly among them.[9] Delays could also occur in the process of coordination between the EC and member state governments with regard to how EC decisions and laws are implemented.[10]

Resolution of the EC's budgetary crisis in February 1988 removed a significant obstacle to European integration. The agreement that reformed EC finances provided enough funds to carry out the 1992 exercise.[11] "The Community can now lift its sights to its manifest destiny."[12]

Attitudes within the European Community

The internal market program was launched amid strong support from both the public and private sectors. Willy De Clercq, EC Commissioner for External Relations and Trade Policy, called the 1992 exercise "the biggest deregulation exercise in the history of Europe, a fundamental restructuring and revitalization of our entire economy."[13] A study commissioned by the EC Commission forecast an increase of 4.25 to 6.50 percent in the GDP of the EC as a whole and the creation of 5 million new jobs as a result of the program.[14] The results of this study have been used by the EC Commission in its information campaign to garner even further support. Lord Cockfield, Vice President of the EC Commission, said that the report "confirmed to every citizen of Europe, that the failure to achieve a single market has been costing European industry millions in unnecessary costs and lost opportunities; that the completion of the Internal Market will provide the economic context for the regeneration of European industry in both goods and services; and that it will give a permanent boost to the prosperity of the people of Europe and indeed of the world as a whole."[15]

EC industries have also been supportive of the internal market process, which they believe will significantly improve Europe's competitive position in the world.[16] The transformation of a fragmented EC market into a single, unified market will provide industries with the opportunity to build economies of scale in production, marketing, and distribution. Production costs should fall as plants are rationalized and fewer product variations are required. New competition will spur technological innovation and greater productivity. A flurry of activity in mergers and acquisitions indicates that many EC firms have already positioned themselves to take full advantage of the benefits of the 1992 process.[17]

Popular support for completion of the internal market remains fairly strong; three out of four EC citizens support plans for unification.[18] Consumers look forward to greater choice and stiffer price competition after 1992. Trade unions condition their support for EC integration on action in the area of social issues.[19] Small business remains uncertain as to whether an integrated market will benefit large corporations at their expense. The realization that there will be losers as well as winners after 1992 is beginning to concern some EC companies.

Individual member states have in general endorsed the internal market program. Although enlargement of the EC from its original 6 members to 12 member countries has increased the difficulty in achieving consensus on many issues in the past, the "back to basics" campaign in the early 1980s renewed awareness in the virtues of the common market.[20] A sense of common purpose has pervaded the EC and has brought strong support of the 1992 integration program.

However, resistance from member countries may increase as the single-market process gains momentum. A large EC membership means that progress towards the 1992 goal involves "breaking down many deeply rooted, centuries old cultural divisions and suspicions among the twelve member nations."[21] EC member states must also accept a significant transfer of authority from the national governments to the EC. Full integration requires constraints on national sovereignty in

[9] Jacques Pelkmans, "An Enterprising Community: The Common Market as Locomotive for Integration," *SAIS Review*, January 1988, p. 147.
[10] Ibid.
[11] Glennon J. Harrison, "The European Community's 1992 Plan: An Overview of the Proposed 'Single Market'," CRS Report to Congress, Sept. 21, 1988, p. 2.
[12] Roy Denman, "A Letter From Europe, A monthly update on the European Community from its Delegation in Washington," No. 48, Feb. 25, 1988.
[13] Willy De Clercq, "The European Community's Place in a Multilateral World." Speech to the World Economic Forum, Geneva, 14 November 1988.
[14] Paolo Cecchini, *The European Challenge, 1992*, 1988.
[15] Ibid., p. xiii.
[16] One such show of support was made on Dec. 13, 1988, by four thousand business leaders representing UNICE (The Union of European Industrial and Employers' Federation) and national industrial federations who adopted a joint declaration on Europe endorsing economic integration and the unified EC market as vital to EC business. Unclassified Department of State cable, "European Business Leaders' Declaration on European Single Market," Dec. 22, 1988, Paris 42142.
[17] James David Spellman, "1992 Prompts Unprecedented Wave of Mergers," *Europe*, December 1988, pp. 26 to 27.
[18] Commission of the European Community, *Eurobarometer, Public Opinion in the European Community*, No. 29, June 1988.
[19] U.S. Department of State, "Western Europe, Regional Brief," November 1988, p. 4.
[20] Jacques Pelkmans, "An Enterprising Community: The Common Market as Locomotive for Integration," *SAIS Review*, January 1988, p. 150.
[21] J. Philip Hinson, "1992 Moves to Center Stage," U.S. Chamber of Commerce, October 1988, p. 2.

particularly sensitive areas, such as tax harmonization.[22] In a speech presented in Bruges, Belgium on September 20, 1988, British Prime Minister Margaret Thatcher confirmed her opposition to European political and monetary union and her concern over ceding national sovereignty to Brussels. Mrs. Thatcher said that in the future, "willing and active cooperation between independent sovereign states is the best way to build a successful European Community." However, she argued that this should "not require power to be centralized in Brussels or decision to be taken by an appointed bureaucracy."[23]

Progress on the White Paper to date has concentrated on the less controversial aspects of the package. As the 1992 deadline draws closer, the more sensitive issues will have to be resolved. Resistance from member countries may increase, and could even result in a breakdown of support should national elections be affected.[24]

Political feasibility of the 1992 action plan also could be thwarted if the costs of short-run sectoral and regional adjustments are weighed more heavily against the long-term economic benefits.[25] Already individuals and groups who feel they may be adversely affected by specific directives have voiced concerns. The less developed member countries have demanded structural funds for regional development to fulfill the Single European Act's promise of "economic cohesion" among the member countries. These countries argue that adjustment to competition in 1992 could bring lasting economic harm to poorer regions and serious tensions between member states if a proper cooperative growth and cohesion strategy is not developed.[26]

Despite these obstacles, member states have made an important commitment to the completion of the internal market. Each country ratified the Single European Act that explicitly states that "the Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992."[27] The structure of the White Paper has also gone a long way towards encouraging the overall momentum of the process. First, the White Paper laid out a plan that seeks to avoid the properties that prompted quarrels and inaction in the past: both large outright claims on the EC budget and issues involving national sovereignty have been minimized.[28] Also, by incorporating a specific timetable, the White Paper has notified the public of all deadlines for action by the official decisionmakers. Finally, the White Paper is a comprehensive document and thus applies to favorable and sensitive issues alike. By insisting that the program is an inseparable whole, the EC Commission "has succeeded in preventing serious backtracking."[29]

Moreover, five countries agreed among themselves to remove controls at their common borders in anticipation of the EC integration deadline. The Schengen Agreement, concluded on June 14, 1985, between France, West Germany, Belgium, Luxembourg, and the Netherlands, calls for open borders as of January 1, 1990.[30] The purpose of this agreement is to act as a stepping stone to complete the EC's internal market exercise, rather than as a competing force. In general, the Schengen countries accept the decisions made by the various EC Councils, but forge their own decisions in areas where the EC-wide process is falling behind. They hope to get a jump on non-Schengen EC countries in terms of formulating policies, evaluating the workability of the agreed solutions, and having the opportunity to provide their own agreed solutions to the rest of the EC. The agreement will also provide a fallback option for these countries should the EC integration process stall. Although progress to date has not been as fast as desired, the Schengen countries should implement harmonized policies 3 years before the EC-wide deadline is effective.[31]

[22] See, for example, J. Philip Hinson, "1992 Moves to Center Stage," U.S. Chamber of Commerce, October 1988,p. 2, or "The European Community's Program for a Single Market in 1992," *Department of State Bulletin*, January 1989, p. 24.

[23] See "European Integration: EEC Member States Should Keep Sovereignty, Says UK Prime Minister," *European Report*, Sept. 21, 1988, p. I-1, and "European Integration: Mrs. Thatcher Continues Her Anti European Union Crusade As Greek Prime Minister Demands Explanation," *European Report*, Sept. 24, 1988, p. I-1.

[24] USITC staff meeting with a professor at Skidmore College. Most experts agree that the more controversial issues remain to be resolved; however, Jacques Pelkmans, speaking at the inaugural conference of the European Community Studies Association at George Mason University on May 24, 1989, argued that the issues still to be addressed are no "tougher" than those already resolved.

[25] Jacques Pelkmans, "An Enterprising Community: The Common Market as Locomotive for Integration," *SAIS Review*, January 1988, p. 148.

[26] *European Report*, No. 1463, Jan. 14, 1989, p. IV-1.

[27] However, failure to meet this deadline will not result in any legal repercussions.

[28] Jacques Pelkmans, "A Grand Design by the Piece? An Appraisal of the Internal Market Strategy," *1992: One European Market?* The European Policy Unit at the European University Institute, Florence, 1988, pp. 362, 372

[29] See Michael Calingaert, *The 1992 Challenge From Europe: Development of the European Community's Internal Market*, (Washington, DC: National Planning Association, [1988]), pp. 29 to 30.

[30] As of June 30, 1989, the elimination of border formalities is not expected to take place as planned on Jan. 1, 1990. Negotiations on the legal procedures for ending border checks are still being conducted. See "Ending of the Border Formalities Stalled by Drug Laws," *The Week in Germany* (June 30, 1989), p. 2.

[31] Unclassified Department of State cable, the Hague 09234, Nov. 8, 1988.

The resolve to complete the internal market process remains strong. At the semiannual summit at Hanover in June 1988, EC leaders declared the process "irreversible." At the Rhodes summit in December 1988, they reconfirmed the "irreversible nature of the movement towards a Europe without internal frontiers." Although broad endorsement is marred by narrowly defined complaints, a strong political consensus may be able to maintain the program's momentum. However, EC leaders recognize that a barrier-free Europe is unlikely by 1992, since it is not likely that all sensitive issues will have been resolved.[32]

Nevertheless, 1992 was never intended to mark the end of the unification process. The 1992 program is a process of integration that predates and will postdate 1992. It "will provide a big stepping stone towards our ultimate goal of political union"[33] that was originally set forth in the Treaty of Rome. EC integration will increasingly move beyond the confines of the single market in such areas as environmental protection, law enforcement, economic policy coordination, and strengthening of existing transport and energy policies. Some EC leaders view financial integration—involving a common European currency, Central Bank, and monetary policy—as a logical consequence of market unification.[34] An overhaul of the EC's institutional framework is also expected.[35]

Third-country concerns

Until 1988, the EC Commission gave little thought to the external aspects of the 1992 program. Subsequently, concerns expressed by officials from the United States and other third countries registered the significance of external issues with the EC Commission. As a result, on October 19, 1988, the EC Commission presented a general policy on the external dimension of the 1992 single market.[36] The EC Commission argues that the 1992 program will benefit EC and non-EC firms alike, through the benefits of working with a single market rather than a partitioned market and through the favorable repercussions of increased growth. The EC also claims that—

"All the relevant economic data demonstrate that it would be absurd for the EC to lean towards protectionism. As the world's biggest exporter, accounting for one-fifth of world trade (compared with the United States, 15 percent; and Japan, 9 percent), highly dependent on international trade (exports represent 10 percent of its GNP, compared with 5 percent for the United States), the Community has a fundamental stake in the existence of free and open international trade."[37]

U.S. foreign policy strongly supports EC integration. An open and prosperous Europe strengthens democracy and the Atlantic alliance and can foster world economic growth. However, the U.S. Government is concerned that increased competition among the 12 member nations may cause EC industry to seek more protection against imports from third countries. Whereas "tariffs are not being raised, and external barriers—with some possible exceptions—are not being raised," U.S. representatives argue that (in the words of a German Economics Ministry official) "there are always voices in Western Europe that present various reasons for protecting uncompetitive companies, branches, and regions."[38] Should European growth rates falter, protectionist pressures could multiply.

Such U.S. claims over the development of a "Fortress Europe" have been attacked by the EC as unfounded. But other nations are concerned as well. Fears abound that the EC's protectionist Common Agricultural Policy will be repeated in the industrial and service sectors. Foreign exporters anxiously await an increase in the aggressive use of antidumping cases, a trend they claim is already apparent, particularly in the imposition of new antidumping rules governing so-called screwdriver factories.[39]

Newspaper releases indicate that Caribbean leaders are concerned that the EC will abandon its current commitments to import their bananas, sugar, and rum. Japanese businessmen particularly fear new EC barriers since EC authorities have warned that they will consider raising tariffs and imposing quotas on Japanese products should the Japanese increase their market shares in Europe as a result of the integration exercise.[40] EC officials have already hinted that an EC-wide quota on Japanese

[32] *European Community News*, No. 23/88, Sept. 15, 1988.
[33] Willy De Clercq, "The European Community's Place in a Multilateral World." Speech to the World Economic Forum, Geneva, Nov. 14, 1988.
[34] In fact, in June 1988 the Hanover European Council established a committee of experts to study and propose concrete stages leading towards European economic and monetary union. Results of their work will be reported at the Madrid EC summit meeting in June 1989.
[35] On Feb. 16, 1989, the European Parliament adopted a resolution calling for a new draft Treaty on European Union to implement institutional reforms. See "European Union: European Parliament Seeks New Impetus for Move Towards Union, but Commission President Urges Caution," *European Report*, Feb. 17, 1989, p. I-5.
[36] "1992: Europe World Partner," *European Community News*, Oct. 20, 1988.
[37] Ibid.
[38] Statement of Franklin J. Vargo, Assistant Secretary for Europe, U.S. Department of Commerce, before the House Small Business Committee, Feb. 9, 1989.
[39] USITC staff meetings with Japan's Ministry of International Trade and Industry, May 8, 1989, and with Richo Company, Ltd. and Matsushita Electric Industrial Company, Ltd., May 15, 1989.
[40] USITC staff meeting with Japan's Ministry of Finance, May 9, 1989.

automobiles may replace current member-state restrictions.[41] Furthermore, the EC Commission has regularly assured the U.S. Government that its directives are actually aimed at Japan; this brings small comfort to the Japanese.[42] The single-market program, as well as the EC's antidumping charges over the past years, have prompted the Japanese to make serious efforts toward becoming better established in Europe.

Even the Council for Mutual Economic Assistance (COMECON), after 30 years of rejecting the EC's legitimacy, signed an agreement in June 1988 establishing official ties with the EC. Soon after, six East European nations, including the Soviet Union, requested formal diplomatic relations with the EC.

EFTA[43] is concerned that its close relationship with the EC is being challenged. Under a 1972 free-trade agreement, industrial goods are traded between the EC and EFTA countries duty free. In comparison with EC goods, EFTA members fear that their industrial exports to the EC would face relatively more red tape and at worse, a decline in relative competitiveness. EC-EFTA cooperation in recent years has addressed the creation of a "European Economic Space" (EES)[44], but Willy de Clercq, EC Commissioner for external relations, noted that the EES will not be an expanded common market. "There is a difference between the European Economic Space and the internal market [in] that only member states can fully participate in this internal market."[45] EFTA members now face three options: to join the EC as full members, to accept the situation that develops, or to arrange a closer association status short of membership.

Certain EFTA countries—in particular, Austria and possibly Norway—are considering joining the EC. The EC Commission, however, has indicated that further enlargement of the EC must be delayed until the end of 1992, after the internal market is completed.[46] The other countries in EFTA argue that neutrality remains a decisive obstacle to full membership.[47] Sweden has proposed semimembership, by which EFTA countries would have access to the EC's internal market in return for abiding by some of the EC's laws and contributing to the EC's budget. So far, the EC has rejected this offer. In the meantime, EFTA's larger companies, like other third-country firms, have been active through mergers and acquisitions to ensure a foothold in the market.

Progress report

The original 300 proposals presented in the White Paper have been reduced to 279 after eliminating some, regrouping others, and adding several new proposals. Following the December 21 Internal Market Council, the last such meeting in 1988, 229 of the 279 pieces of legislation required to create the single market had been proposed by the EC Commission and 107 had been adopted by the Council (not including the 5 partial adoptions). These figures translate into approximately 82 percent of the total legislation for proposed directives and regulations, and about 38 percent for adopted internal market measures. The EC Commission had set a target in July 1987 of introducing 90 percent of the proposals by the end of 1988. The Council's record also falls short of a goal to have 50 percent of the measures adopted or supported by "common positions" by yearend. Fifteen common positions—the stage of the cooperation procedure where the Council can be considered to have reached political agreement—were pending at yearend.[48]

In November 1988, the EC Commission adopted the half-way progress report[49] on the internal market process required under article 8b of the Single European Act.[50] Lord Cockfield, Vice President of the EC Commission, said that the progress achieved to date was cause for satisfaction. Progress in the area of technical barriers has been particularly commendable; 70 percent of the directives and measures adopted relate to technical barriers as defined in the White Paper. Considerable progress has also been made as to financial services and capital movements. However, in three main areas progress has fallen behind. These disappointments have been in the fields of plant and animal health, taxation, and "Citizen's Europe," or the free movement of people. Border controls affecting the free movement of citizens have been a particularly sensitive area, since they

[41] For more information, see ch. 11 of this report.
[42] USITC staff meetings with Japan's Ministry of International Trade and Industry, May 8, 1989, and the Industrial Bank of Japan, May 9, 1989.
[43] The member nations of EFTA are Norway, Sweden, Finland, Iceland, Austria, and Switzerland.
[44] For a discussion of the European Economic Space, see Esko Antola, "The European Economic Space: New Dimension of Economic Integration in Western Europe," a paper prepared for the IPSA XIV World Congress, Washington, DC, Aug. 28 to Sept. 1, 1988.
[45] Remark by Willy de Clereq at EC-EFTA Ministerial-level meeting in Brussels on Feb. 2, 1989. See, Frances Williams, "'Europanic' Grips the EC's Small Neighbors," *Journal of Commerce*, July 6, 1988, p. 5A.
[46] For example, see "European Commission: Reflection and Political Message on EEC Enlargement," *European Report*, May 3, 1988, p. V-3, or George Reisch, Secretary-General of EFTA, "1992 a tremendous challenge for EFTA," *EFTA Bulletin*, January 1989, pp. 6 to 9.
[47] See, for example, "EEC/Switzerland: EEC Membership Not An Option, Says Government Report," *European Report*, Sept. 16, 1988, p. V-4.
[48] Unclassified Department of Commerce cable, Brussels 17308, Dec. 22, 1988.
[49] "EC Commission Evaluates Progress of 1992 Program," *European Community News*, Nov. 10, 1988.
[50] Art. 8B of the Single European Act requires the EC Commission to report to the Council before Dec. 13,

are "linked to progress in intergovernmental cooperation to combat terrorism, international crime, drug trafficking and trafficking of all kinds."[51]

In its assessment of the progress of the 1992 program, the European Council noted at the Rhodes summit in December that the internal market exercise "has already created a new dynamism in the European economy." However, the EC leaders also noted that "the pace of work must be stepped up in the future, because if account is taken of the time needed to transpose Community law into national legislation the Council in fact has only two years in which to meet the 1992 objective." The European Council noted particularly that progress should be accelerated in the areas of taxation, transport and energy, animal and plant health controls, and the free movement of people.

Institutional Mechanism for the 1992 Program

The EC[52] developed from three original communities, each based on its own founding treaty. The Treaty of Paris, signed April 18, 1951, established the European Coal and Steel Communities.[53] The Treaties of Rome,[54] of March 25, 1957, established both the European Economic Community and the European Atomic Energy Community.

The communities were merged into the EC in two stages, first by the Convention on Certain Institutions common to the European Assemblies in 1957,[55] and second by the Treaty Establishing a Single Council and a Single Commission of the European Communities, signed April 8, 1965.[56]

The EC pursues its objectives by means of a legal system independent of and superior to[57] the laws of its member states. EC law creates rights and obligations not only for the EC institutions and member states but also for the latters' citizens.

The EC Institutions

The EC acts through four principal institutions: the EC Commission, the Council of Ministers, the European Parliament, and the European Court of Justice.[58]

The EC Commission

The Commission of the European Communities works to ensure "the proper functioning and development of the common market."[59] The EC Commission currently consists of 17 members[60] appointed to 4-year terms by mutual agreement among the governments of the

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[50] —Continued
1988, and again before Dec. 31, 1990, on the progress made towards achieving the internal market within the time limit fixed in art. 8A, a period expiring on Dec. 31, 1992. (The EC Commission also reports annually on the internal market program each spring.)

[51] "EC Summit Leaders Assess Progress of 1992 Program," *European Community News*, Dec. 6, 1988. For a discussion of the issues in plant and animal health controls and taxation, see part II of this report.

[52] The EC originally comprised six member states, signatories to the establishing treaties: Belgium, West Germany, France, Italy, Luxembourg, and the Netherlands. The United Kingdom, Denmark, and Ireland joined the EC under the Act of Accession, Jan. 22, 1972, TS 16 (Command Paper (Cmd.) 5179, 7461) [hereinafter 1972 Act of Accession]. Greece joined pursuant to the Act of Accession, Nov. 19, 1979, 18 *Official Journal of the European Communities (O.J. Eur. Comm.)* (No. L 291) (Cmd. 7650) [hereinafter 1979 Act of Accession]. Spain and Portugal entered the EC under the Act of Accession, Nov. 15, 1985, 27 *O.J. Eur. Comm.* (No. L 302) (Cmd. 9634) [hereinafter 1985 Act of Accession].

[53] Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951, T.S. No. 16 (Cmd. 7461) [hereinafter ECSC Treaty].

[54] Treaty Establishing the European Economic Community, Rome, Mar. 25, 1957; TS 1 (Cmd. 5179) [hereinafter EEC Treaty], and Treaty Establishing the European Atomic Energy Community, Mar. 25, 1957, TS 1 (Cmd. 5179) [hereinafter Euratom Treaty].

[55] The convention, an attachment to the Rome treaties, provided for a single Assembly and a single Court of Justice for all three communities, and a single Economic and Social Committee (ESC) for the EEC and the Euratom.

[56] Treaty Establishing a Single Council and a Single Commission of the European Communities, Apr. 8, 1965 [hereinafter Merger Treaty]. This Treaty also created a Committee of Permanent Representatives of the Member States (COREPER), which prepares the work of the EC Council and carries out tasks assigned it by the Council. EEC Treaty, art. 151, as amended by Merger Treaty, art. 4. Members are appointed by their national governments, have ambassador rank, and are the heads of their respective national missions to the EC. Members defend their national interests, but are also largely responsible for defending EC interests in their respective countries.

[57] Firma Foto Frost v. Hauptzollamt Lubeck Ost, case No. 314/85, [1987-88 Transfer Binder] Common Market Reporter (Common Mkt. Rep.) (CCH) par. 14,484 (1987). Unless otherwise specified, citations to judicial decisions in this chapter are to judgments of the European Court of Justice.

[58] A diagram of the institutions and their roles in the integration program appears in fig. 1-1.

[59] EEC Treaty, art. 155. The EC Commission receives technical assistance from the Economic and Social Committee (ESC), a body composed of 189 "representatives of the various categories of economic and social activity, in particular, representatives of producers, farmers, carriers, workers, dealers, craftsmen, professional occupations and representatives of the general public." EEC Treaty, arts. 193 to 194, 197. In many instances the Commission and the Council are required to consult the ESC before taking formal action. See, e.g., EEC Treaty, arts. 43, 49, 54, 63, 75, 79, 100.

[60] Merger Treaty, art. 10, as amended, art. 15, 1972 Act of Accession; Council decision of Jan. 1, 1973, Altering the Number of Members of the Commission, 1973 *O.J. Eur. Comm.* (No. L 2) p. 28; art. 15, 1979 Act of Accession; art. 15, 1985 Act of Accession. The Council may modify, by unanimous vote, the number of members comprising the EC Commission. See, e.g., 1973 *O.J. Eur. Comm.* (No. L 2) p. 28.

member states.[61] Members must satisfy three requirements: member-state citizenship, "general competence," and independence. Members may "neither seek nor take instructions from any Government, or from another body" and may not engage in any other occupation during their term of office.[62]

Article 155 of the EEC Treaty confers various powers and obligations on the EC Commission. Most important for the 1992 integration program, the EC Commission proposes the directives, regulations, and other measures that are intended to effect integration. The EC Commission also takes enforcement measures against treaty violators.[63] The EC Commission may proceed against a member state or an EC institution by either issuing a reasoned opinion[64] or instituting suit in the Court of Justice.[65] Normally the EC Commission is afforded considerable flexibility in its choice of measures. Article 155 provides for the use of nonbinding recommendations and opinions, but the EC Commission also has issued directives, regulations, and decisions.[66] It has been argued that article 155, which grants the EC Commission "its own power of decision," confers broad implied powers upon the EC Commission.[67] Most Treaty provisions specifically delimit the powers of the various EC institutions, but the EC Commission seems to consider that it has implied powers to take action when an EC institution obligated to act, generally the Council, fails to act.[68]

[61] Each member state delegates at least one, but no more than two, individuals to the Commission.
[62] Merger Treaty, art. 10 (1), (2). The EC Commission has an administrative staff of about 11,000 divided among more than 20 directorates general and agencies.
[63] Although the language of art. 155 refers to only the EEC "Treaty," in practice the EC Commission ensures application of the Treaty, its protocols, annexes, and amendments. The EC Commission is also responsible for ensuring application of international agreements concluded pursuant to art. 228 of the EEC Treaty.
[64] See EEC Treaty, art. 169.
[65] EEC Treaty, arts. 169, 173, 175. Other methods of enforcement are provided in particular circumstances. See, e.g., EEC Treaty, arts. 93, 225.
[66] See P. Herzog and H. Smit, Law of the European Economic Community sec. 155.13 (1988); Common Mkt. Rep. (CCH) par. 4472.07.
[67] EEC Treaty, art. 155; Herzog and Smit secs. 155.04, 155.10.
[68] See e.g., 1981 *O.J. Eur. Comm.* (No. C 244) p. 1 (Declaration of the EC Commission). The EC Commission stated that the Council had failed to take necessary action to conserve fishery resources and, as a precaution pending Council action, called on member states to comply with the proposals the EC Commission had made to the Council, and which the EC Commission considered as binding. The EC Commission drew support from Commission v. United Kingdom, case No. 804/79, 1981 E.C.R. 1045, which held that the United Kingdom had violated the treaty by imposing a system of fishing licenses without EC Commission authorization. In Officier van Justitie v. J. van Dam and Zonen, case No. 124/80, Common Mkt. Rep. (CCH) par. 8763 (1982), the Court endorsed the EC Commission's position more directly, by ruling that although the EC had exclusive power to act in the fisheries sector, where

Adoption of any measure by the EC Commission requires the assent of a majority of all the members provided for in article 157, regardless of the members' actual presence at an EC Commission gathering.[69] Decisions made in the absence of a quorum[70] are subject to attack under article 173, but such attacks are rarely successful because EC Commission deliberations are kept confidential, to protect collegiality and independence from national pressures.[71]

The Council of Ministers

The EC Council, responsible for most EC decisionmaking, is composed of cabinet-level representatives from each of the EC's member states.[72] Presidency of the Council is rotated among the delegates for 6-month terms.[73] The Council meets when convened by the President at his own initiative, at the request of one of the Council members, or at the request of the EC Commission.[74]

The Council exercises powers conferred upon it by article 145 of the EEC Treaty.[75] In addition to acting in a legislative capacity,[76] the Council, in some cases, exercises executive authority.[77] The Council has certain "constitutional" powers.[78]

[68]—*Continued*
the Council had failed to adopt the required measure, a national measure enacted with the approval of the EC Commission was valid.
[69] Although EC Commission rules do not allow giving proxy, representatives may attend EC Commission meetings in members' absence. See Rules of Procedure, arts. 4, 9.
[70] The EC Commission's quorum consists of eight members, as set out in the EC Commission's Rules of Procedure.
[71] See Rules of Procedure, art. 8.
[72] The precise composition of the Council differs depending on the matter under discussion, e.g., agricultural matters are normally dealt with in a meeting of Ministers of Agriculture.
[73] Originally the rotation was alphabetical by the names of the member states in their national languages. The current order is as follows: (1) for a first cycle of 6 years, Belgium, Denmark, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, Netherlands, Portugal, United Kingdom; (2) for a second cycle of 6 years, Denmark, Belgium, Greece, Germany, France, Spain, Italy, Ireland, Netherlands, Luxembourg, United Kingdom, Portugal. Merger Treaty, art. 2, as amended, art. 11 of the 1972, 1979, and 1985 Acts of Accession. This order ensures that all member states have a chance to preside during the busy period just before summer recess, and the period at the end of the calendar year, during which the annual budget is determined.
[74] EEC Treaty, art. 147, as amended by the Merger Treaty, art. 3.
[75] EEC Treaty, art. 145; Merger Treaty, arts. 1 to 6.
[76] Most legislative activity by the Council is initiated by an EC Commission proposal and often requires consultation with the Assembly as well. E.g., EEC Treaty, arts. 7, 28, 43 (3), 49, 51, 75, 87, 99, 100.
[77] E.g., EEC Treaty, arts. 44 (4), 73 (1), 93 (2), 109 (3).
[78] In some cases the Council may alter the scope of treaty provisions. E.g., EEC Treaty, arts. 38 (3), 55, 84, 126. Under arts. 136, 188, and 235 of the EEC Treaty, the Council can bypass art. 235, the amendment provision, and effectively amend the treaty without doing so formally.

The body also holds primary responsibility for administrative and financial decisionmaking,[79] and relations with both international organizations and third countries.[80]

Under article 145, the Council is charged with the duty of coordinating the general economic policies of the member states.[81] It has been argued that article 145 is essentially descriptive, and that the Council derives substantive powers only from other parts of the treaty,[82] but the Council has not adopted such a narrow view of its powers to coordinate economic policy.[83]

The Council's voting procedures are governed primarily by articles 148, 149, and 150 of the EEC Treaty. Article 148 specifies four relevant voting procedures: simple majority, qualified majority acting on a proposal from the EC Commission, qualified majority acting at the Council's own initiative, and unanimous vote.[84] The Council adopts decisions by a simple majority of its members unless the treaty specifically provides otherwise.[85] The simple majority vote reflects the principle of equality among sovereign states yet fails to account for such political and practical realities within the EC as relative sizes of member states. Consequently, most provisions authorizing Council action do, in fact, specify alternative voting procedures.

The most frequently mentioned voting procedure is that of the "qualified majority."[86] This weighted voting more closely reflects the political and economic positions of the member states; the weight reflects some measure of population and economic strength.[87] Qualified voting takes two forms. When the Council acts upon a proposal of the EC Commission, 54 affirmative votes must be cast. When the Council acts on its own, a qualified majority again requires 54 votes, but these must be cast by at least 8 different member states.[88]

Unanimous voting procedure governs decisions that involve changes to the treaty,[89] the composition of the EC,[90] and special economic relations.[91] And notwithstanding treaty provisions for other voting procedures, after the "Luxembourg Compromise" in 1966,[92] most important decisions were taken by a unanimous vote.

The Single European Act[93] changed voting procedure to facilitate the EC integration program. The act divides Council proceedings into two categories—those governed by the act's "cooperation procedure," i.e., primarily those concerning the single market[94] and those not so governed. Article 149 (1) applies in cases where the cooperation procedure is inapplicable and the Council is acting on a proposal from the EC Commission.[95] If the Council seeks to amend part of the proposal, the EC Commission may accept or reject the amendment. If the EC Commission accepts it, the Council can adopt the amended proposal by the normally required majority. If the EC Commission rejects the amendment, the Council may adopt the amended proposal only by a unanimous vote. The Council may modify the reasoning of the EC Commission by majority vote but may modify the legal form of the proposal, by, for example, adopting a directive instead of a regulation, only by unanimous vote.[96]

[79] E.g., EEC Treaty, arts. 203, 209; Merger Treaty, arts. 6, 24.
[80] E.g., EEC Treaty, arts. 111, 113, 116, 228, 237, 238.
[81] See, e.g., EEC Treaty arts. 2, 3 (g), 6, and 100.
[82] Herzog and Smit, sec. 145.06; Common Mkt. Rep. (CCH) par. 4402.12.
[83] For example, the Council has created a number of committees that are intended to ensure close cooperation between committee members and the EC. Compare 1970 *O.J. Eur. Comm.* (No. C 24) p. 4 (EC Commission reply to written question No. 398 of 1969 by Vredeling), 1970 *O.J. Eur. Comm.* (No. C 56) p. 13 (EC Commission reply to written question No. 3 of 1970 by Vredeling).
[84] EEC Treaty, art. 148, as amended, art. 14, 1972, 1979, and 1985 Acts of Accession. When more than one article governs, the strictest voting procedure applies.
[85] Ibid.
[86] E.g., EEC Treaty, arts. 7, 25, 28, 43, 44, 54, 57, 63, 69, 70, 75, 79, 87, 94, 98, 99, 101, 103, 113, 116, 127; Merger Treaty, art. 24; Single European Act, arts. 49, 56 (2), 100A, 100B, 118A, 130Q(2).
[87] In qualified majority voting, votes are weighted as follows:

Belgium	5	Ireland	3
Denmark	3	Italy	10
West Germany	10	Luxembourg	2
Greece	5	Netherlands	5
Spain	8	Portugal	5
France	10	United Kingdom	10

EEC Treaty, art. 148 (2).
[88] EC Commission participation ensures a degree of impartiality, so a larger consensus among member states is required to support decisions that lack such participation. Similarly, when a qualified majority is required, abstention is the equivalent of a negative vote. Abstentions do not prevent adoption of acts that require unanimity, EEC Treaty, art. 148 (3), and, in fact, are often used to express displeasure with Council decisions. Herzog and Smit secs. 148.05 to .07. Regardless of applicable voting procedure, under art. 150 Council members may give proxy to any other Council member, although no member may receive more than one proxy.
[89] E.g., EEC Treaty, arts. 84 (2), 126 (b), 138 (3), 203, 205.
[90] E.g., EEC Treaty, art. 237.
[91] E.g., EEC Treaty, art. 238.
[92] Under the "Luxembourg Compromise" reached in January 1966, the Council agreed that, in cases where the Council is authorized to adopt an EC Commission proposal by a qualified majority, adoption should nevertheless be by unanimous vote if important member-state interests are involved. Although not legally binding, the compromise encourages "package" bargaining and negotiation within the Council.
[93] Single European Act, effective July 1, 1987, reprinted in 1986 *EC Bulletin* supp. No. 2.
[94] See below for a further discussion of the cooperation procedure.
[95] See, e.g., EEC Treaty, arts. 28 (customs duties) and 69 (free movement of capital).
[96] EEC Treaty, art. 149. The European Council, as distinguished from the Council of the European Communities, is composed of the heads of state or of government of the member states and meets to discuss issues of political cooperation outside EC jurisdiction. Until the passage of the Single European Act, these discussions could influence the actions of the EC Council, but could not be relied upon as EC authority. Title I, art. 2, as well as provisions of titles II and III, of the Single European Act confirmed the legal basis of

The European Parliament

The European Parliament, also referred to as the Assembly of the European Community, is composed of 518 members,[97] and exercises "advisory and supervisory powers."[98] Members were originally appointed to Parliament by the various national parliaments, but since 1979 have been elected by direct popular vote for 5-year terms.[99] Members sit by party affiliation rather than by nationality.[100] Parliament elects its own officers, a President, 12 Vice Presidents, and 5 Quaestors (Administrators), for 2-1/2-year terms.

Parliament's powers are measured by the applicable treaty provisions, and thus the institution has no "inherent" powers. Parliament supervises the EC Commission through its public review of the EC Commission's annual general report,[101] its power to censure the EC Commission,[102] and the right of review in certain budgetary matters.[103] Generally, the Parliament may act only upon vote by an absolute majority, but there are exceptions to this rule, such as in the case of a motion to censure.[104] One-third of the Assembly members constitutes a quorum.[105]

Parliament may intervene in cases before the European Court of Justice,[106] although this right of intervention is less powerful than the EC Commission's and the Council's right to directly attack EC measures.[107] Under article 175 of the EEC Treaty, however, Parliament has standing in the Court of Justice to sue the Council or the EC Commission for a failure to act in infringement of the treaty.[108]

Finally, through the use of formal questions addressed to the EC Commission and the Council, the Parliament supervises the institutions' activities, forces them to define their positions, encourages new initiatives, and obtains information on future policy developments.[109] The EC Commission is obliged to respond to

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[98]—*Continued*
the European Council and included the President of the EC Commission in its deliberations. Although the exact role of the European Council in EC decisionmaking is still not defined, the Single European Act seems to emphasize that political cooperation is critical to attaining integration.

[97] Representation by member state is as follows:

Belgium	24	Ireland	15
Denmark	16	Italy	81
West Germany	81	Luxembourg	6
Greece	24	Netherlands	25
Spain	60	Portugal	24
France	81	United Kingdom	81

EEC Treaty, art. 138 as amended. Member states are represented in the Assembly in proportion to their national populations, but no member state has fewer than 6, nor more than 81, delegates. As a result, the smaller countries, such as Denmark, Ireland, and Luxembourg, may be overrepresented in the Assembly.

[98] EEC Treaty, art. 137. The Parliament meets in plenary session once a month in Strasbourg, has its Secretariat in Luxembourg, and has its members' offices in Brussels.

[99] See EEC Treaty, art. 138 (3); Act Concerning the Election of the Representatives of the Assembly by Direct Universal Suffrage (1976 *O.J. Eur. Comm.* No. L 278) p. 5, amended by the 1979 and 1985 Acts of Accession. On July 25, 1978, after all member states had ratified procedures and enacted implementing legislation, the heads of state adopted a "decision" whereby the first direct elections of the European Parliament would be held June 7 through June 10, 1979. Council decision 1978 *O.J. Eur. Comm.* (No. L 205) p. 275.

[100] The Socialists and the European Peoples Party (Christian Democrats) have been the most heavily represented in recent years. Many smaller parties have joined to form "party groupings" in order to take advantage of various privileges, including financial contributions for administrative expenses. In order to qualify, groupings must meet a minimum threshold membership, currently 21 members for a group composed of delegates from 1 member state, 15 for groupings representing 2 countries, and 10 for groupings of 3 nationalities. Herzog and Smit, sec. 138.06.

[101] The EC Commission publishes annually, at least 1 month before the opening session of Parliament, a general report on EC activities. Parliament is obligated to discuss the general report in a forum of public debate. EEC Treaty, art. 143.

[102] EEC Treaty, art. 144. A motion of censure has been introduced only three times in the history of the European Parliament. Two of the motions were withdrawn, and the third was overwhelmingly defeated.

[102]—*Continued*
Any political group in Parliament, or one tenth of the Assembly's members, may introduce a motion to censure based on the EC Commission's alleged failure to properly carry out its duties. Upon a vote of censure by two thirds of an absolute majority, the EC Commission is obligated to resign collectively, to be replaced by agreement among the member states under art. 11 of the EEC Treaty. See Herzog and Smit, secs. 144.05 to .07.

[103] Art. 203 of the EEC Treaty originally provided the Parliament with only an advisory function, but the Parliament's powers have increased through Council decisions 1970 *O.J. Eur. Comm.* (No. L 94) 19, 1973 *O.J. Eur. Comm.* (No. L 2) p. 7, 1971 *O.J. Eur. Comm.* (No. L 2) p. 1, and 1977 *O.J. Eur. Comm.* (No. L 359) p. 8.

[104] Merger Treaty, art. 142; Rules of Procedure of the European Parliament, art. 112. Voting by the European Parliament is governed by arts. 141 and 142 of the EEC Treaty, and arts. 71 and 72 of Parliament's Rules of Procedure.

[105] Originally, under art. 33 (2), (4) of the Rules of Procedure, a majority of Assembly members comprised a quorum. The rules were amended, 1973 *O.J. Eur. Comm.* (No. C 95) p. 4, with the current quorum provision. Parliamentary positions are always given in the form of a resolution to the Presidents of the Council and the EC Commission pursuant to Rules of Procedure of the European Parliament, art. 47. Resolutions are published in the "C" series of the Official Journal.

[106] Protocol on the Statute of the Court of Justice of the European Economic Community, art. 37.

[107] EEC Treaty, art. 173.

[108] European Parliament v. Council of the European Communities, case No. 13/82, [1985-86 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,191 (1985). In that case, the Court found that the Council had failed to adopt a common transportation policy, and held that the Council must either approve the EC Commission's proposals concerning transportation, some of which dated back to 1967, or take other action within a reasonable time.

[109] Since direct election began in 1979, Parliament has used its questioning power with increasing zeal. Between 1958 and 1967, 56 questions were addressed to the Council. In 1984 alone, the Council received 235 oral and 262 written questions. The EC Commission is also being questioned more, from an average of approximately 600 per year in the early 1970s to 526 oral and 1976 written questions in 1984.

questions posed by the Parliament or its members.[110] The EEC Treaty does not provide for questions addressed to the Council, but in 1958, the Council agreed to receive questions from Parliament[111] with the understanding that such questions would concern only subjects on which the Council had already made decisions.[112]

The European Court of Justice

Article 164 of the EEC Treaty provides for a Court of Justice designed to "ensure that in the interpretation and application of [the] Treaty the law is observed."[113] The Court is currently composed of 13 judges,[114] who must be impartial and either eligible for appointment to the highest judicial office in their respective countries or legal experts of universally recognized competence.[115] A judge need not be a national of a member state, but, as a practical matter, member states have chosen nationals as their "delegates" to the Court.[116] Judges sit for a term of 6 years and are eligible for reappointment at the end of a term.[117]

The Court generally sits in plenary sessions, but may create "chambers," consisting of three to five members, to hear particular categories of cases, or cases with especially complex facts. The Court always sits in plenary session for cases brought by either a member state or an EC institution and for preliminary questions submitted for determination by national tribunals pursuant to article 177.[118]

Article 164 provides that the Court shall ensure compliance with "law," but leaves the term "law" undefined. In practice, the Court has looked to the treaties, their amendments and implementing measures, Rules of Procedure of the various institutions, and decisional law. In addition, the Court has, on many occasions, looked to "general principles" of both international[119] and national law[120] for guidance. But despite the Court's willingness to consult national law, the Court will not construe national law. The Court will ascertain what meaning national courts have given a national law and will then determine whether the national law is compatible with treaty obligations.[121]

The Court's powers are defined in articles 169 through 184 of the EEC Treaty and depend on the type of case before it. Articles 169 and 170 provide for review of allegations of a member state's failure to fulfill treaty obligations.[122] Articles 173 through 176 and article 184 grant

[110] EEC Treaty, art. 140. To sanction failures to respond in a timely manner, Parliament may publish the questions unanswered in the "C" series of the Official Journal.

[111] Such consent from the Council was necessary because art. 140 gives the Council control over the conditions under which it is heard by Parliament.

[112] The Council has on occasion responded to questions concerning pending matters and on general treaty matters outside the areas of the Council's responsibility. In general, Council's responses have been vague and unsatisfactory to most parliamentarians, perhaps largely because the Council tries to answer questions with the agreement of all members. Herzog and Smit, sec. 140.09.

[113] EEC Treaty, art. 164. The Court was created by the ECSC Treaty, and opened in 1952 with seven judges. The Court then took up the judicial function under the EEC and Euratom treaties when they went into effect. The Court's powers and procedures vary with respect to the applicable treaty. See the three treaties, the statutes annexed to them, the Convention on the Common Institutions, the Instruments of Accession, and the Rules of Procedure of the Court of Justice of the European Communities, promulgated Mar. 3, 1959, 1959 *O.J. Eur. Comm.* p. 349, as supplemented, 1962 *O.J. Eur. Comm.* p. 113, and revised, 1974 *O.J. Eur. Comm.* (No. L 350) p. 1. References to treaty articles herein are generally to the EEC Treaty, because the 1992 integration program deals more with economic concerns than with specific nuclear, coal, or steel matters.

[114] EEC Treaty, art. 165. "Should the Court of Justice so request, the Council may, acting unanimously, increase the number of Judges and make the necessary adjustments" to portions of this article and art. 167. Ibid.

[115] EEC Treaty, art. 166. The Court is assisted by six Advocates General who submit to the Court "reasoned reports," to be rendered with "impartiality and independence," containing case analyses and references to pertinent authorities and source materials. In addition, the Advocates General assist in the overall development of EC law, because the reasoned report, submitted to the Court publicly, discusses in detail commentators' views and prior case law where the Court's opinion often does not.

[116] Because Judges are chosen "by common accord of the Governments of the member states," EEC Treaty, art. 167, and because the Court may be composed of individuals from all members states, in practice each state has selected its own nationals, and other member states have afforded deference to the selection.

[117] EEC Treaty, art. 167. "Every three years there shall be a partial replacement of the Judges. Seven and six Judges shall be replaced alternately." Ibid.

[118] EEC Treaty, art. 165.

[119] See, e.g., Commission v. Italian Republic, case No. 10/61, Common Mkt. Rep. (CCH) par. 8002 (1962) (relying on "principles of international law" in holding that a state that assumes a new obligation renounces incompatible rights derived from an earlier treaty). But see Commission v. Grand Duchy of Luxembourg and Kingdom of Belgium, case Nos. 90-91/63 (1964), Common Mkt. Rep. (CCH) par. 8028 (1965) (holding that when principles of traditional international and EC law are incompatible, the latter shall prevail and declining to apply the traditional rule that a party is justified in refusing compliance with an agreement that has been breached by its contract partner).

[120] See, e.g., Alvis v. Commission, case No.32/62, 2 Common Mkt. L. Rep. p. 396 (1963) (applying to the EC Commission "generally accepted . . . administrative law of the Member States of the EEC" requiring official institutions to afford employees an opportunity to be heard in conjunction with disciplinary proceedings). See also Stauder v. City of Ulm, case No. 29/69, Common Mkt. Rep. (CCH) par. 8077 (1970) (holding that citizens' fundamental rights, derived from member states' national constitutions, are included in general principles of EC law).

[121] Herzog and Smit, sec. 164.07; Friedrich Stork and Co. v. High Authority of the Coal and Steel Community, case No. 1/58, Common Mkt. Rep. (CCH) par. 4602.40 (1959).

[122] Under art. 169, the EC Commission acts as the complainant, whereas under art. 170, another member state initiates proceedings against the alleged violator. These proceedings are discussed in more detail below.

jurisdiction to review acts of the Council and EC Commission. Article 172 provides for review of Council decisions to impose particular penalties, article 177 grants review of preliminary questions of EC law arising within a national tribunal, and finally, articles 178 through 183 enable the Court to act as a court of first instance in specified situations.[123] Jurisdiction in all of these instances is exclusive to the Court, and the Court has no discretionary authority to refuse to hear a case for which it has jurisdiction.[124]

Under article 173, the Court reviews the acts[125] of the Council and the EC Commission.[126] The article neglects to grant jurisdiction for review of Parliamentary acts, but in 1983 the Court extended its review to Parliamentary acts.[127] Article 175 complements article 173 by allowing member states, other EC institutions,[128] and natural or legal persons to sue because of inaction by either the Council or the EC Commission.[129] [130] Article 176 imposes upon an "[i]nstitution whose act has been declared void or whose failure to act has been declared contrary to th[e] Treaty" the obligation to comply with the judgment of the Court.[131] However, if the institution fails to comply with the directions of article 176, the complainant can do nothing more than institute a new suit under either article 173 or article 175.

Because the Court's caseload was increasing steadily, particularly in the area of employment matters, the Single European Act provided for the establishment of a court of first instance if requested by the Court of Justice and approved by the Council.[132] In October 1988 the Council adopted a decision establishing a Court of First Instance of the European Communities.[133] The Court will hear such matters as disputes between the EC and its employees, certain actions relating to competition rules, and certain actions relating to matters covered by the ECSC.[134] After 2 years, the Council will consider whether to give the Court of First Instance competency to hear dumping and subsidy cases. Decisions by the Court of First Instance are appealable in whole or in part to the Court of Justice, but review is limited to points of law only.

The lower court will consist of 12 members, serving renewable 6-year terms, with one-half of the court being replaced every 3 years. Most cases will be heard by chambers of three to five members. Members must be independent and be qualified to be judges in their respective countries.

[123] Art. 178 grants the Court jurisdiction in disputes relating to noncontractual damages caused by an EC institution or employee. Art. 179 covers review of disputes between the EC and its servants. Art. 180 provides for review of disputes concerning the Statute of the European Investment Bank. Finally, art. 181 gives the Court jurisdiction over arbitration clauses in contracts concluded by or on behalf of an EC institution.

[124] Herzog and Smit, p. 5-313.

[125] Although recommendations and opinions were not explicitly covered, presumably because of the their nonbinding effect, the Court has interpreted "acts" to include both types of measures. The Court has also assumed jurisdiction in certain cases involving negotiations with member states. See Commission v. Council, case No. 22/70, Common Mkt. Rep. (CCH) par. 8134 (1971).

[126] Actions may be brought by a member state, the Council, the EC Commission, and by a natural or legal person for whom an EC act is of direct and individual concern. Grounds for action are infringement of the Treaty and related laws and procedures, lack of competence, and misuse of powers. EEC Treaty, art. 173. Unlike cases against member states under arts. 169 and 170, art. 173 actions must be instituted within 2 months of publication of the relevant measure or of notification to the plaintiff. If an art. 173 action is inappropriate, a natural or legal person can seek redress in a national tribunal, which may refer questions of EC law to the Court under art. 177.

[127] Parti Ecologiste "Les Verts" v. European Parliament, case No. 294/83, [1985-86 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,317 (1986). The Court held that, under art. 164, the Court must insure that EC law is observed and therefore must have the authority to review any EC institution action that is intended to have legal effect with respect to third parties. The Court further held that natural and legal persons could bring an action when an EC institution's act is of "direct and individual concern" to such persons. Parliament welcomed the holding that the acts of all EC institutions are reviewable, but argued against review of purely internal Parliament administration. Parliament argued further that, as a matter of symmetry, the Parliament ought to be empowered to challenge acts of the Council and EC Commission under art. 173. Resolution, 1986 *O.J. Eur. Comm.* (No. C 283) p. 85 (1986); Herzog and Smit, sec. 173.07.

[128] Art. 175 is distinguishable from art. 173 in that the former grants Parliament power to initiate suit, whereas the latter does not.

[129] The Court has interpreted this article to include suits between the Council and the EC Commission. See, e.g., Commission v. Council of the European Communities, case No. 383/87, Common Mkt. Rep. (CCH) par. 16,002 (1988) (Action for failure of Council to establish draft budget).

[130] Upon service by plaintiff of a demand for action, the institution has 2 months to define its position. If it fails to, action may be brought in the Court within another 2 months. If the Court finds the institution's inaction was improper, it may issue a declaratory judgment to that effect. If the institution issues a timely defined position, plaintiff may take issue with it by bringing suit under art. 173.

[131] EEC Treaty, art. 176. This applies to both art. 173 and art. 175 cases.

[132] For that purpose, arts. 4, 11, 26 of the Single European Act added art. 168A to the EEC Treaty, art. 32d to the ECSC Treaty, and art. 140A to the Euratom Treaty.

[133] Council decision No. 8677/88, following a political agreement reached on July 25, 1988. Common Mkt. Rep. (CCH) par. 95,026 (1988).

[134] The article does not extend competency to hear actions brought by member states or by EC institutions, or questions referred for a preliminary ruling under art. 177. EEC Treaty, art. 168A.

The 1985 White Paper and the Single European Act

The 1992 integration program originated in two EC documents, the White Paper issued by the EC Commission in June 1985, and the Single European Act.[135] The EC Commission issued the White Paper as a discussion of the broad goals of the integration program and set out a proposed timetable for completion of the program by 1992. The White Paper is divided into three parts and a timetable annex, which has been updated in annual progress reports. The three parts concern the removal of physical barriers between member states through abolition of frontier and other controls; the removal of technical barriers to the free movement of, among other things, goods, labor, and capital; and the removal of fiscal barriers by such measures as the harmonization of value-added taxes. The White Paper has no binding legal effect, as the Council need not adopt the EC Commission's proposals, but it has greatly influenced the course of integration as the blueprint for the program.

The Single European Act, which is referred to above in discussions of the functions of the EC institutions, instituted changes in those functions in preparation for the passage of the internal market measures that are intended to carry out the integration program discussed in the White Paper. Of most importance to the integration program is the cooperation procedure set forth in article 149 (2) of the act, which changes the voting procedure for issuing directives and broadens Parliament's role in the legislative process. The procedure governs certain designated treaty provisions,[136] selected because of their significance in the 1992 integration program, as contemplated in the new article 8A of the EEC Treaty.[137]

The approval process for internal market proposals

The EC is establishing the 1992 integration program principally by Internal Market Proposals, some of which are issued as regulations, decisions, or recommendations, but most of which are issued as directives.[138] The proposals are generally issued according to the cooperation procedure described in article 149 (2). In all instances, the Council acts on a proposal from the EC Commission. After obtaining an opinion from the European Parliament, it must then, by a qualified majority, take a "common position" on the EC Commission proposal, without, as yet, formally adopting a measure. Any substantial departure from the EC Commission proposal must be by unanimous vote.[139] The Council and the EC Commission then inform the European Parliament of the Council's position and reasoning, as well as the EC Commission's position. For its second reading, Parliament has 3 months to act, though this period may be extended for 1 month by agreement with the Council.

If the European Parliament objects to the Council's "common position," it has two options. It may, within 3 months, and by an absolute majority of its members, vote to reject the "common position." If, in spite of Parliament's rejection, the Council chooses to formally enact the measure on which it took a "common position," it must do so by unanimous vote within 3 months. If the Council fails to act within this period, and the period has not been extended by common accord of Council and Parliament, the EC Commission proposal lapses.

If Parliament proposes amendments to the Council's "common position," the EC Commission may reexamine the proposal in light of the amendments proposed by Parliament and submit to Council a new proposal. This proposal may, but need not, incorporate Parliament's amendments, but the proposal must be accompanied by the unincorporated amendments. The Council may adopt these unaccepted amendments, but must do so within 3 months, and by unanimous vote. The Council may adopt the EC Commission's proposal by a qualified majority but must act unanimously if it wishes to depart from the proposal. Although article 149 (2) (e) states that the Council "shall" adopt the EC Commission's proposal, the proposal lapses if the Council fails to act within 3 months.

The Single European Act, though increasing Parliament's role in the legislative process, still leaves the body dependent upon the EC Commission for leverage in obtaining approval of its amendments. If the EC Commission incorporates Parliament's amendments into its revised proposal to the Council, the Council cannot depart from the EC Commission's proposal, and thus from Parliament's amendments, except by a unanimous vote.

[135] Single European Act, effective July 1, 1987, reprinted at 1986 *EC Bulletin* supp. No. 2.

[136] Art. 6 (1) of the Single European Act provides that the procedure shall be instituted for acts based on EEC Treaty arts. 7, 49, 54 (2), 56 (2), 57, 100A, 100B, 118A, 130E, and 130Q (2).

[137] Herzog and Smit, sec. 149.05.

[138] On some topics, the EC also issues nonbinding position statements called Green Papers. In the area of standards, the Council delegates some responsibility for developing specific norms to technical organizations such as CEN and CENELEC. See below for a discussion of the legal distinctions between the various types of measures.

[139] Art. 149 (2) requires that the Council act "under the conditions of paragraph 1," which requires unanimity for amendments to EC Commission proposals. EEC Treaty, art. 149 (2).

However, if the EC Commission, which, according to some, tends to be more conscious of political realities in the member states than does Parliament,[140] chooses not to incorporate some or all of Parliament's proposals, Parliament is in a weak position because the Council may adopt proposals not accepted by the EC Commission only by a unanimous vote. Furthermore, it is unlikely that the Council will unanimously depart from its "common position," especially considering that the Council was aware of the Parliament's ideas when taking that position. Thus, article 149 (2) somewhat enlarges the role of Parliament but does not deprive the Council of its primary legislative authority.

The form and effect of internal market measures

The form and effect of an EC action are spelled out by treaty. Article 189 defines the five forms of legal instruments available to the Council and the EC Commission for the purpose of carrying out their respective tasks in accordance with treaty provisions: regulations, directives, decisions, recommendations, and opinions.[141]

Regulations, both basic and implementing,[142] are characterized by three elements: general applicability, binding effect in entirety, and direct applicability in member states. Member states may neither adopt national measures that at all interfere with the application of a regulation,[143] apply a regulation in an incomplete or selective manner so as to deprive the regulation of its effectiveness,[144] nor conceal the EC character of a regulation by reenacting it as national legislation.[145] Regulations need no implementing legislation to ensure effectiveness; in fact, regulations prevail over both prior and subsequent national law, including national law of a constitutional rank.[146]

Decisions are binding in their entirety, but unlike regulations, are individual in scope, providing legal consequences for only those specifically addressed. Decisions may be addressed to member states or to individuals. In principle, decisions addressed to member states are not directly applicable, although an individual may, if the "legal nature, context and wording" are appropriate, invoke it in the courts. Decisions addressed to individuals are always directly applicable.[147]

Recommendations and opinions are nonbinding, but they are classified as "legal acts," and as such, may be reviewed by the Court of Justice. Recommendations, which merely invite the addressee to take certain action, may be issued to member states, or individual entities, and even from the EC Commission to the Council. Opinions merely express the EC Commission's or the Council's opinion on a particular factual or legal situation.[148]

Directives are binding upon the member states to which they are addressed only as to the result to be achieved but leave to the member state the choice of the form and methods of implementation.[149] Because directives normally require that member states pass implementing legislation in order to be fully effective, the issuance of internal market directives will not in itself bring about EC integration. The EC hopes to complete the issuance of directives by 1990, leaving 2 full years for the member states to accomplish the monumental task of transposing the directives into national law.

The implementation process for internal market measures

Implementation of the 1992 integration program has already encountered difficulties. Both the Federal Republic of Germany and Ireland had to resolve constitutional problems

[140] Herzog and Smit, sec.149.05.

[141] EC Treaty, art. 189. Art. 191 requires that regulations be published in the *Official Journal* of the EC. Although there is no equivalent provision governing directives and decisions, in practice they are usually published in the *Official Journal* as well.

[142] Basic regulations, setting out fundamental principles of EC law, are generally adopted by the Council upon a proposal of the EC Commission. The EC Commission on occasion issues implementing regulations, which it considers to be binding.

[143] See Granaria v. Produktschap voor Veevoeder, case No. 18/72, 18 Rec. 1163, 1172 (1972).

[144] Commission v. Italian Republic, case No. 39/72, Common Mkt. Rep. (CCH) par. 8201 (1973).

[145] See, e.g., Amsterdam Bulb BV v. Hoofdproduktschap voor Siergewassen, case No. 50/76, [1976 Transfer Binder] Common Mkt. Rep. (CCH) par. 8391 (1977).

[146] Herzog and Smit, sec. 189.10. The Single European Act amended art. 145 to provide that the Council "confer on the EC Commission, in the acts which the Council adopts, powers for the implementation of the rules which the Council lays down." EEC Treaty, art. 145, as amended by art. 10 of the Single European Act. Although generally all regulations are of equal rank, with only later regulations superseding earlier measures, when

[146]—*Continued*
the EC Commission exercises a delegated power, the regulation adopted may not conflict with the act that prompted the delegation of authority. This same rule of supremacy applies to directives and decisions. Herzog and Smit pp. 5-576 to 5-577.

[147] EEC Treaty, art. 189; Herzog and Smit, sec. 189.18.

[148] EEC Treaty, art. 189; Herzog and Smit., sec. 189.19.

[149] The Court of Justice has held, "As regards the transposition of the directive into national law, it must be observed that this does not necessarily require the provisions of the directive to be enacted in precisely the same words in a specific, express provision of national law; a general legal context may be sufficient if it actually ensures the full application of the directive in a sufficiently clear and precise manner." Commission v. Italian Republic, case No. 262/85, [1987-88 Transfer Binder] Common Mkt. Rep. (CCH), par. 14,518 at 18,963 (1987), citing Commission v. Federal Republic of Germany, [1985-86 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,203 (1985). In the Italian case, the directive concerned environmental protection, and the Court stated that, "a faithful transposition becomes particularly important in a case such as this, in which the management of the common heritage is entrusted to the member states in their respective territories." Commission v. Italian Republic, p. 18,963.

before they could ratify the Single European Act.[150] The United Kingdom has expressed an unwillingness to eliminate frontier controls. As to the directives themselves, member states' reactions may vary widely depending on the country and the directive. In the area of excluded-sector government procurement, for example, the EC has issued draft directives. Some governments have set few rules for purchasing by state entities and have not passed the legislation or regulations needed to respond to the market-opening initiative set out in the draft directives. The West German Government, on the other hand, already has significant procurement regulations[151] and is already working to insure compliance with EC policy in excluded-sector procurement.[152]

The EC Commission monitors how well member states comply with EC directives.[153] In its recent Fifth Annual Report to the European Parliament on EC Commission Monitoring of the Application of Community Law, the EC Commission transmitted detailed information concerning each member state's level of compliance. Some countries, notably Italy and Greece, have a significantly poorer record than others in implementing directives.[154] Italy has a long legislative process, due in part to frequent dissolutions of its Parliament and the consequent lack of continuity.[155] In the Second Annual Report, the EC Commission noted that Greece has had constitutional and administrative difficulties integrating into the EC legal order, but has made significant progress.[156]

Procedures for dispute resolution

In principle, all member states are obligated to pass appropriate implementing legislation concerning each EC directive within the time provided in the directive. In practice, this process sometimes fails. Failure to fulfill this obligation under the EC treaties can lead to various means of dispute resolution.

Article 169 of the EEC Treaty provides that the EC Commission may bring suit in the European Court of Justice against a member state for failure to fulfill an obligation arising under the treaties.[157] The EC Commission has on many occasions taken a member state to task in this way for failing to properly implement a directive. A proceeding is often brought on the basis of a complaint to the EC Commission by an EC citizen, although the EC Commission can also bring an action on its own or on the basis of a question or petition from Parliament.[158] With the advent of the 1992 integration program, the EC Commission now sees article 169 as "an instrument for the achievement of a policy" rather than as a solely legal instrument, and has resolved to more closely monitor and ensure compliance with EC integration measures.[159]

Suits under article 169 involve two-step procedures. The EC Commission first issues to the member state a statement describing its alleged acts or omissions. Generally this is preceded by discussions with the member state for the purpose of either resolving problems informally or ascertaining additional relevant facts. If it finds the member state guilty of a violation, the EC Commission will issue a "reasoned opinion," specifying the obligations breached, providing reasons for its conclusions, and finally, giving the member state a time period within which to comply with its obligations. If the member state fails to comply within the designated time period, typically 1 month, the EC

[150] See Common Mkt. Rep. (CCH) pars. 10,832, 10,849.

[151] Verdingungsordnung fur Leistungen (1984); see also A Guide to Government and NATO Tendering in the Federal Republic of Germany (U.S. Department of Commerce, International Trade Administration, September 1987).

[152] See, e.g., Reform of the Postal and Telecommunications System in the Federal Republic of Germany (May 1988). Referring to the EC Commission's Green Paper on the Development of the Common Market for Telecommunications Services and Equipment (June 1987), the West German Government states that it "has incorporated the guidelines of the Green Paper as well as the principles of the EEC Treaty in the planned restructuring of the telecommunications market so that the envisaged liberalization is completely embedded in the European policy and the European legal system." Ibid., p. 36.

[153] The monitoring role was assigned to the EC Commission in 1977. It is a difficult task, especially when member state legislatures add amendments that make implementing legislation unclear. Report on behalf of the Committee on Legal Affairs and Citizens' Rights on the monitoring of the application of Community law by the member states, European Parliament Working Documents 85-86, Oct. 9, 1985, Series A, doc. A2 112/85, p. 15.

[154] See COM(88) 425, Oct. 3, 1988. For example, in its table 13, the report lists how many directives requiring implementation have in fact been implemented by the following member states:

Member state	Directives applicable as of Dec. 31, 1987	Directives transposed as of Dec. 31, 1987
Belgium	795	637
West Germany	795	663
Denmark	779	649
France	790	652
United Kingdom	784	636
Greece	782	567
Italy	794	567
Ireland	781	607
Luxembourg	789	631
Netherlands	783	631

[155] European Parliament Working Documents 85-86, Oct. 9, 1985, series A, doc. A2 112/85, p. 17.

[156] COM (85) 149 Final, p. 3.

[157] Under art. 170, another member state may initiate similar proceedings against the alleged violator. Typically, however, member states avoid confrontation with one another and choose to pursue a suit with the EC Commission as the actual complainant.

[158] Citizen complaints have more than doubled in 5 years, reflecting increased public awareness of EC law. A complaint to the EC Commission is "the most direct and effective instrument available to the citizen to ensure the application of Community law, leaving aside of course proceedings before a national court." COM(88) 145, p. 5.

[159] Ibid.

Commission may initiate Court proceedings by submitting an application to the Court Registrar, who then serves notice on the member state.[160] In general, the EC Commission reports, the number of cases brought to the Court of Justice has declined because member states prefer to comply after the EC Commission issues a "reasoned opinion," rather than wait for litigation.[161]

The Court issues a declaratory judgment; it cannot order or invalidate any particular action on the part of a member state. Instead, member states found in violation of a treaty obligation are directed by the treaty itself to "take necessary measures to comply with the judgment of the Court of Justice."[162] Although no time limit is set on member-state implementation of a Court judgment, the Court expects member states to take immediate steps to comply.[163] If a member state fails to take sufficient corrective measures, article 169 can be invoked in a new proceeding. However, this may not solve anything, because if a member state refused to act properly after a first judgment, there is little to suggest that a second judgment will have a more coercive effect.

The EC Commission often brings suit because a member state has simply failed to take any action to implement a directive.[164] Partial or ineffective implementation is also grounds for suit.[165] Other situations can give rise to an action as well, such as the passage of member-state legislation that is inconsistent with a directive.[166]

In litigation with the EC Commission concerning failure to comply with a directive, member states have raised various defenses. A common one has been that there was insufficient time to pass the necessary legislation. The Court has rejected such arguments, noting that member states' representatives participate in the directive-drafting process and therefore have considerable notice of EC actions.[167] The Court has also rejected as irrelevant a member state's unilateral declaration on how it will interpret a directive issued at the time the directive is passed.[168] A member state may plead force majeure as a defense, i.e., that failure to implement the directive was due to factors beyond the member state's control, but reasonable efforts to overcome the obstacle must be shown.[169]

Private parties may not bring an action against a member state before the Court of Justice, but may sue in a national tribunal. If, in such a case, questions of EC law arise, the suit may appear before the Court of Justice pursuant to article 177.[170] If a directive is sufficiently precise and

[160] Under art. 170, a member state may commence an action by submitting to the EC Commission a statement of alleged infringements. Both states are afforded an opportunity to be heard before the EC Commission, both orally and in writing. The EC Commission then delivers a reasoned opinion on the matter, whether or not it finds a violation. Unlike reasoned opinions issued in conjunction with art. 169, those issued under art. 170 need not provide a time period within which to make amends. At the conclusion of this stage, the member state may file suit in the Court; the member state may do so regardless of the EC Commission's determination and regardless of efforts by the alleged violator to come within treaty compliance.

[161] COM (88) 145, p. 4.

[162] EEC Treaty, art. 171.

[163] Commission v. Italian Republic, case No. 131/84, [1985-86 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,262 (1985).

[164] See, e.g., recent cases listed at Common Mkt. Rep. (CCH) 16,002 et seq.: Commission v. French Republic, case No. 312/86, Oct. 25, 1988; Commission v. Italian Republic, case No. 310/86, July 12, 1988; Commission v. Kingdom of Belgium, case No. 283/86, June 21, 1988; Commission v. Denmark, case No. 278/85, Oct. 14, 1987; Commission v. Federal Republic of Germany, case No. 208/85, Oct. 14, 1987; Commission v. Kingdom of the Netherlands, case No. 236/85, Oct. 13, 1987.

[165] Commission v. Kingdom of Belgium, case No. 215/83, [1983-85 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,188 (1985) (Member state must implement directive in every respect, even if member state considers unimplemented aspect of little importance). Administrative practices, as opposed to formal legislation, are generally unacceptable forms of implementation, because they can be changed at the whim of the member state Government, and they often lack sufficient publicity. Commission v. Italian Republic, case No. 145/82, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8923 (1983)

[166]—*Continued*
(Administrative practices are generally unacceptable and in this case were issued too late and only partially implemented directive). A member state may delegate implementation to regional or local authorities, but it must also pass binding implementing measures on the national level. Commission v. Kingdom of the Netherlands, case No. 96/81, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8841 (1982).

[167] See, e.g., Commission v. United Kingdom of Great Britain and Northern Ireland, case No. 60/86, [1987-88 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,508 (1988) (United Kingdom requirement that motor vehicles carry dim dip lighting devices was improperly stricter than EC directive's standard, because it interfered with free movement within the EC).

[168] Commission v. Italian Republic, case No. 136/81, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8917 (1982). See also Commission v. Italian Republic, case No. 49/86, [1987-88 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,520 (1987); Commission v. Grand Duchy of Luxembourg, case No. 58/81, [1981-83 Transfer Binder], Common Mkt. Rep. (CCH) par. 8860 (1982); Commission v. Kingdom of Belgium, case No. 148/81, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8918 (1982); Commission v. Ireland, case No. 151/81, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8920 (1982).

[169] Commission v. Kingdom of Denmark, case No. 143/83, [1983-85 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,156 (1985).

[169] Commission v. Italian Republic, case No. 101/84, [1985-86 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,228 (1985) (Bomb attack on Government records may have constituted force majeure, but it cannot be blamed for continued lack of effort to replace records).

[170] The member-state court may seek from the Court of Justice "criteria of interpretation relating to Community law which may enable it to assess" whether the member state law is compatible with EC law. Syndicat National des Fabricants Raffineurs d'Huile de Graissage v. Groupement d'Interet Economique "Inter Huiles," case No. 172/82, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8913 (1983).

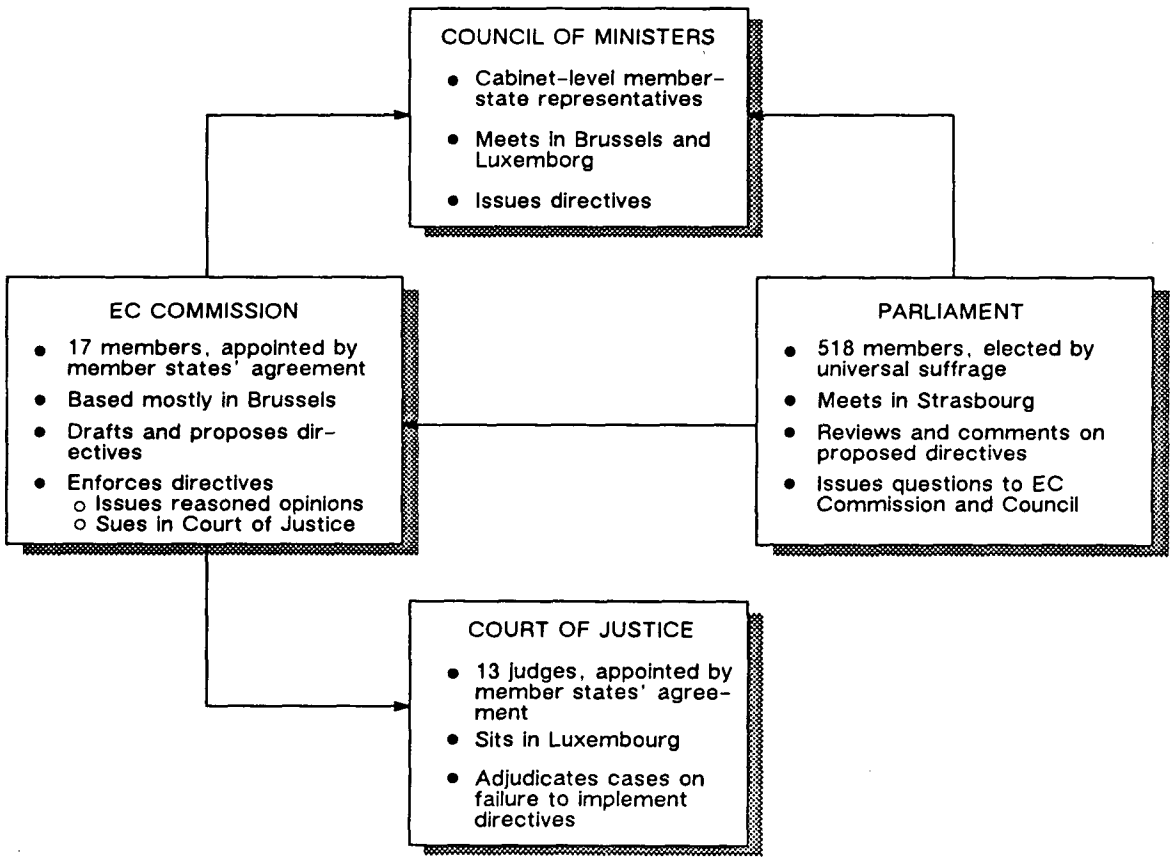
unconditional, an individual may rely on provisions of the directive in court when a member state has failed to correctly interpret the directive in implementing legislation.[171] When member-state law is inconsistent with a directive, an individual may use the directive in defense even against a penal sanction, but only after the deadline for the member state to pass implementing legislation.[172] According to the EC Commission, although most national courts correctly apply EC law, some courts have shown ignorance of or reluctance to apply EC law and have misused the concept of acte claire, thinking they could discern the clear meaning of an EC measure without consulting the Court of Justice under article 177.[173]

[171] D.J. Smit Transport B.V. v. Committee of the Netherlands International Road Haulage Organization on the Commercial Carriage of Goods Abroad, case No. 126/82, [1981-83 Transfer Binder] Common Mkt. Rep. (CCH) par. 8902 (1983). See also Von Colson v. Land Nordrhein Westfalen, case No. 14/83, [1983-85 Transfer Binder] Common Mkt. Rep. (CCH) par. 14,092 (1984) (Directive did not specify type of sanction, so directive is not specific enough for individuals to rely on to strike down sanction provided in member-state legislation).

[172] Public Prosecutor v. Ratti, case No. 148/78, [1978-79 Transfer Binder] Common Mkt. Rep. (CCH) par. 8569 (1979).

[173] See, e.g., COM(88) 145, table 11, citing Consorts Genty, French Conseil d'Etat judgment of July 10, 1987 (French court should have invoked art. 177 rather than construe Treaty of Rome art. 36, which Court of Justice has rarely considered).

Figure 1-1
Principal EC Institutions and their roles in 1992 Integration



Source: The European Community (EC Office of Press and Public Affairs, 1987).

CHAPTER 2
REVIEW OF CUSTOMS UNION THEORY AND RESEARCH ON THE 1992 PROGRAM

CONTENTS

Chapter 2

Review of Customs Union Theory and Research on the 1992 Program

Introduction

This chapter begins by discussing the underlying economic theory of market integration—often referred to as customs union theory. In economic theory, when a customs union is formed, two primary effects result—trade creation and trade diversion. Customs union theory predicts that trade will be simultaneously created among members of the union and diverted away from nonmembers. It is possible, however, that nonmembers may benefit. If the barriers resulting from integration, considered collectively, are lower than before the union was formed, nonmembers may benefit from access to the new, larger market. Moreover, resulting economic growth, within the union, may lead to an increase in aggregate demand, which is likely to be satisfied in part by nonmembers. However, whether the members of the customs union or nonmembers, on balance, will benefit from the market integration is an empirical question that cannot be predicted from theory.

After a brief review of customs union theory, this chapter also reviews recent empirical research that has examined the expected impact of completing the integration of the internal market within the EC by 1992. According to this research, the removal of many nontariff barriers will cause firms to rethink their development strategies to adapt to the new situation. Many firms now protected by these barriers will face increased competition. Other firms will want to be prepared to exploit newly created opportunities in the marketplace. The result will be elimination of some inefficient producers and greater efficiency and scale economies for others. The primary beneficiary of the integration will be consumers, who will benefit from lower prices. Moreover, the expansion of trade is likely to improve the quantity and quality of consumer choices.

At the macroeconomic level, the reduction in costs and prices is expected to lead to increased purchasing power in member states. Moreover, the efficiency gains is predicted to improve the competitive position of producers in EC member states and lead to increased growth potential. In addition, the completion of the internal market is expected to lead to an easing of the major macroeconomic constraints that currently affect the EC's economic situation, such as budget deficits, trade deficits, and inflationary pressures.

The following section presents a brief discussion of customs union theory. The ensuing sections of the chapter address the effects on nonmembers, the microeconomic effects of the EC 1992 integration, and the macroeconomic effects. The final section reviews a series of reports under the general heading of the "Cost of Non-Europe."

Customs Union Theory

Customs unions are geographical trading areas wherein the member states reduce trade barriers among themselves and adopt common barriers against the rest of the world.[1] The 1992 EC economic integration program contains elements both of reduced internal barriers and harmonized border policies against other, nonmember countries.

Economists have long assessed the effects of customs unions.[2] As internal trade barriers are lowered, consumers in each member country find that imports from other member countries are now less expensive relative to both domestic products and imports from nonmember countries. Thus, consumers in each country may buy more imports from other member countries and may decrease consumption of domestic products and nonmember imports. On the other hand, the creation of a customs union may result in increased trade with nonmember countries at the expense of domestic production for domestic consumption if the harmonized barrier against nonmember countries is lower than the average individual national barriers prior to the union's formation.

The two primary trade effects are (1) trade creation: The shift away from production for domestic consumption toward member imports and production for export to other member countries; and (2) trade diversion: The shift away from consumption of nonmember imports and from exports to nonmember countries in favor of trade with member countries.

This conventional dichotomy serves to highlight the gains to efficiency arising from trade creation, which shifts production toward low-cost producers, and the offsetting losses to efficiency arising from trade diversion, which shifts production away from low-cost producers. Whether, on balance, efficiency increases or

[1] Customs unions are often distinguished taxonomically from preferential trading clubs (PTCs) and free trade areas (FTAs). PTCs are geographic regions within which member states have reduced internal barriers but wherein each maintains its own external barriers against the rest of the world. FTAs are PTCs in which the internal barriers have been eliminated. In some definitions, a customs union requires complete elimination of internal barriers (except on the services of capital), see Chacholiades (1978), p. 545. The definition used in the text, however, does not treat the services of capital as an exception and allows barriers to persist at a level below those set against the rest of the world.

[2] For the seminal, early work on the modern theory of customs unions, see Jacob Viner, *The Customs Union Issue*, (Carnegie Endowment for Peace [1950]), ch. IV.

decreases depends on the relative strength of the two effects and has to be assessed empirically.

Finally, customs unions tend to enhance competition by creating a larger market under liberalized trading rules. By allowing production of each good to migrate to relatively efficient locations, economies of scale and scope as well as cost reductions based on cumulated production (learning-curve effects) are more readily realized in select industries, often those that incur large fixed costs. The achievement of size-related economies is one of the chief rationales offered for the EC integration plans. Moreover, to the extent the customs union spurs additional economic growth related to scale or location economies, the member countries will become wealthier. This increase in wealth, may, in turn, increase imports from nonmembers as EC consumers spend their additional income.

Since the United States is outside of the EC, measures that reduce internal barriers but leave external barriers unchanged cause trade diversion, that is, increased trade among EC member states at the expense of trade between the United States and the EC. Diversion hurts both U.S. export producers, who lose export markets in the EC, and U.S. consumers, who must compete against increased internal EC demand for European exports. U.S. import-substitution industries, however, benefit from trade diversion because European exports are diverted, to some extent, to internal EC consumption. On the other hand, measures that reduce the harmonized EC barriers against nonmember countries, including the United States, lower the price of U.S. goods in Europe and thus benefit U.S. exporters.

Existing Research on the 1992 Program

The above discussion presents what economic theory might predict when a customs union is formed. The following section reviews the only known piece of research that uses customs union theory as a basis to predict the impact of the 1992 program on nonmembers.[3] That section is followed by a review of recent empirical research that assesses the likely impact of the integration for the EC as a whole as well as the impact for specific sectors of the EC economy. This empirical research focuses primarily on the impacts expected among the EC member states.

[3] At this time there is no known empirical research assessing the impact of the 1992 program on nonmember countries.

Impact of the 1992 Program on Nonmembers According to Customs Union Theory

Balassa (1988) examines some of the implications of the 1992 program for non-EC members under the basic tenets of customs union theory. Balassa believes that abolishing border formalities or more realistically, simplifying regulations is equivalent to reductions in tariffs on intra-area trade and may have trade-diverting effects by favoring member producers over nonmember producers. Similarly, the costs of complying with the standards of the importing country will disappear as far as member producers are concerned under the 1992 program. The fact that member producers will no longer have to be concerned with other members' standards may result in a loss of competitiveness for non-EC suppliers in EC markets, irrespective of whether national standards are accepted or harmonized EC standards are established. Hence, in goods trade, Balassa concludes that the completion of the internal market in the EC will result in trade diversion. However, Balassa notes that as economic growth occurs during the implementation of the 1992 program, nonmember countries should benefit through increased imports. He also concludes that these beneficial dynamic effects should, to some extent, offset static trade diversion.

Overall Impact of the 1992 Program on Members of the EC

Microeconomic Effects

In a study by the Directorate-General for Economic and Financial Affairs (DGEFA) of the EC Commission entitled, "The Economics of 1992: An Assessment of the Potential Economic Effects of Completing the Internal Market of the European Community," (hereafter referred to as The Economics of 1992), the microeconomic evidence on the costs of barriers and the benefits of integrating markets has been divided into two categories: barrier-removal effects and market-integration effects. Barrier-removal effects are further subdivided into the cost of barriers affecting trade and the cost of barriers affecting all production. Market-integration effects are subdivided further into the economies of scale[4] gained through restructuring and increased

[4] Economies of scale cause the average cost of production to decline as a firm increases its output. For a more complete treatment of this topic see Shepherd (1985).

production and the effects of competition on X-inefficiency[5] and monopoly rents.[6]

The DGEFA found that barriers affecting trade directly are typically border delays at customs posts and related administrative costs. As these barriers are lifted, additional costs imposed on imports are reduced, thus enabling prices on these imports to fall. This price decrease will usually result in a greater expenditure on these imports. Barriers affecting all production are typically those that limit competition. For instance, government-procurement restrictions keep domestic prices above competitive levels by excluding less costly imports. National standards regulations are likely to have similar effects. In the service sectors, regulatory policies may also operate in a protective fashion, raising domestic costs and prices. When these barriers are removed, costs and prices should fall.

The DGEFA believes that as increased competition leads to restructuring of industries and rationalization of production, scale economies will be gained. Hence, the economy becomes more efficient. However, there are important sources of inefficiency other than those resulting from a suboptimal production structure. These sources are usually grouped under 'X-inefficiencies,' which include overmanning, excess inventories, and excess overhead costs. Increased competition will tend to decrease X-inefficiencies and monopoly rents.

The DGEFA gathered much of the data on the savings expected from the1992 integration from surveys conducted throughout the EC. In table 2-1, their estimates of the welfare gains from completion of the internal market are presented. These gains are the sum of the gains for consumers and producers and are approximately equal to the increase in real income for the economy.

The diverse sources of information and assumptions lead to four different totals, ranging from 127 billion European Currency Units (ECU) to 187 billion ECU.[7] These gains correspond to a range of 4.3 to 6.4 percent of EC Gross Domestic Product (GDP). The barrier-removal effects turn out to be somewhat less than half of the total effects, and the market-integration effects, which would rely heavily on the effectiveness of competition policy to be fully achieved, make up the rest.

[5] X-inefficiency refers to the efficiency losses stemming from nonmaximizing behavior of firms. X-inefficiency is characterized by wasteful use of resources that raises the overall cost of production. Increased competition resulting from the 1992 initiative should discipline firms to use their resources more efficiently.

[6] Monopoly rents is a term sometimes used to describe excess profits that are gained through and protected by monopolistic or oligopolistic market structure.

[7] The ECU is a currency unit based on a basket of community currencies, and on June 30, 1989, 1 ECU = $1.059.

Several caveats need to be taken into account when considering the figures. First, the ECU-estimated gains are for 7 of the 12 member states (West Germany, France, Italy, the United Kingdom, and the Benelux) and are based on data for 1985. These seven countries account for 88 percent of the GDP for the entire EC. Second, the hypothesis regarding 'completion' of the internal market could lead to overestimation of the gains. The assumption that all barriers will be eliminated may turn out to be too optimistic. Third, the DGEFA was unable to take into account the likely favorable impact of competition on innovation and technological progress, and this inability could cause them to underestimate the gains. Fourth, there is some question as to whether the postulate that all resources freed by rationalization would be immediately reemployed is realistic. If these resources are not reemployed, the gains could be overestimated. It is estimated by DGEFA that it will take 5 to 10 years for all adjustments to be completed. Finally, since the figures used by the DGEFA are taken from estimates made independently from many sectors, possible second-order effects due to interactions among the sectors are ignored; however, DGEFA believes that this problem is not likely to result in any significant bias in the estimates.

Macroeconomic Effects

In "The Economics of 1992," the DGEFA also made a macroeconomic assessment of completing the internal market to accompany the microeconomic estimates discussed in the previous section. Two econometric models were used to estimate the macroeconomic effects: the EC Commission's Hermes model and the Organization of Economic Cooperation and Development's (OECD) Interlink model.[8] The Hermes model has nine branches and covers the principal EC countries.[9] The Hermes model links national economies through bilateral trade in five products. The Interlink model complements Hermes by describing all the EC countries and, in addition, some non-EC countries. Also, Interlink provides a description of monetary and financial sectors. These models are used to make quantitative assessments of four major changes: abolishing frontier controls, opening up public procurement, liberalizing financial services, and supply effects stemming from increased competition.

[8] For a more detailed discussion of these models see annex B of "The Economics of 1992." Also, on the Interlink model see Richardson (1977), and on the Hermes model see Valette and Zagome (1988).

[9] The countries included are Belgium, France, Italy, and the United Kingdom. The models for West Germany and the Netherlands are not complete.

Table 2-1

Estimates of the total economic gains from completing the internal market, according to partial equilibrium estimation methods[1]

Item	Variants		Variants	
	A	B	A	B
	Billion ECU		Percent GDP	
(1) Cost of barriers affecting trade only	8	9	0.2	0.3
(2) Cost of barriers affecting all production	57	71	2.0	2.4
Total direct costs of barriers	65	80	2.2	2.7
(3) Economies of scale from restructuring and increased production	60	61	2.0	2.1
(4) Competition effects on X-inefficiency and monopoly rents	46	46	1.6	1.6
Total market-integration effects:				
Variant I (sum of 3 and 4)	106	107	3.6	3.7
Variant II (alternative measure for 3 and 4)	62	62	2.1	2.1
Total of costs of barriers and market-integration effects:				
Total I (1+ 2+ Variant I)	171	187	5.8	6.4
Total II (1+ 2+ Variant II)	127	142	4.3	4.8

[1] Based on data from 1985.

Notes.—Variants A and B relate to alternative primary sources of information. Variants I and II relate to different approaches to evaluating competitive effects. Details of these procedures are given in annex A in "The Economics of 1992."

Source: "The Economics of 1992."

According to the DGEFA, abolishing frontier controls will reduce the costs of intra-EC trade by eliminating customs delays and administrative formalities and will cause job losses either in the public sector (customs officers) or in the private sector (forwarding agents, staff of firms handling the administrative burdens of customs clearance). The DGEFA believes the fall in trade costs will improve efficiency and should improve the EC's trade balance with the rest of the world.[10] According to the simulations, EC GDP would rise by nearly 0.4 percent in the medium term (5 to 10 years). Although some job losses might occur in the short term, the favorable dynamic effect of external trade should persist, thus leading to 200,000 new jobs for the EC as a whole. Owing to the elimination of customs jobs and the upturn in economic activity resulting from increased trade, it is estimated that, on average, the net budget position for the EC would improve by 0.2 percent of GDP. Also, it is estimated that inflationary pressures would fall and result in a 1.0-percent decline in the inflation rate.

The DGEFA asserts that the opening up of public procurement will have three primary effects: (1) a static effect resulting in savings through the use of foreign suppliers with lower prices, (2) a competition effect resulting in lower prices from national suppliers, and (3) a restructuring effect, in which suppliers would have to restructure in order to achieve productivity gains that would enable them to compete effectively. The simulations predict that the opening up of procurement would increase EC GDP by 0.5 percent, would reduce consumer prices by nearly 1.5 percent, would reduce budget deficits by 0.3 percent of GDP, and, on average, would improve external trade balances for the EC in the medium term. It is also estimated that 350,000 new jobs would be created. It must be noted that it is assumed that the opening up of public procurement is limited to the EC and therefore only benefits EC suppliers.

According to the DGEFA, the liberalization of financial services and the removal of existing barriers is expected to promote free competition and limit the monopoly rents that the segmentation of the EC market into several national markets currently provides. The liberalization of financial services would play a crucial supporting role in the completion of the internal market. It would ensure that EC growth was not thwarted by a shortage of capital. The simulations predict that this liberalization would increase EC GDP by almost 1.5 percent, reduce prices by 1.4 percent, and improve the net budget position by 1.1 percent of GDP as well as improve the external trade balance, on average, by 0.3 percent of GDP for the EC (in the medium term).

[10] DGEFA argues that each member state would benefit from improved terms of trade brought about by a fall in import prices. Moreover, the EC as a whole would increase its trade balance in volume terms in relation to the rest of the world. Therefore asserts DGEFA, external trade would have a positive effect on EC GDP.

It is also predicted that about 400,000 jobs would be created in the EC.

DGEFA notes that the estimates in this study of the supply effects should be thought of as merely illustrative since they combine an optimistic hypothesis with a tendency to underestimate the gains. The optimistic hypothesis is that firms will have a reasonably high degree of success in exploiting newly created opportunities. However, the simulations tend to underestimate the gains since they neither include all sectors nor take into account all of the supply effects. The primary gain from the supply effects is greater competition, which reduces both X-inefficiencies and monopoly rents. It is estimated that EC GDP would increase by 2.1 percent, prices would fall by 2.3 percent, budget deficits would fall by 2.2 percent of GDP, and the collective trade balances of EC members would improve by 0.4 percent of GDP in the medium term. Moreover, employment is estimated to increase by 850,000 jobs. The figures for the gains from changes in government procurement, from liberalization of financial flows, and from increased competition are presented in table 2–2.

According to the simulations, the total gains from completion of the internal market would be an increase in EC GDP of between 3.2 and 5.7 percent, a reduction of inflation of between 4.5 and 7.7 percent, and an easing of domestic budget balances and trade balances of between 1.5 and 3.0 percent of GDP and between 0.7 and 1.3 percent of GDP, respectively (all in the medium term). It is also estimated that the labor market would improve, with the creation of between 1.3 million and 2.3 million jobs in the EC as a whole over the medium term. However, it is expected that the unemployment rate would fall by only 1 to 2 percent in the medium term.

Review of Sector-Specific Studies

In 1986 the EC Commission launched a research program under the general heading of the "Cost of Non-Europe." This series of sector-specific reports was conducted for the EC Commission by various authors and was completed in 1988. The reports sought to establish the present costs of the EC's market fragmentation, and hence, the potential benefits of integration, by analyzing the impact of market barriers. The costs inherent in these barriers were examined both in reports dealing with the principal barriers impeding market integration and in studies of the impact of specific examples of barriers in representative sectors of the EC's service and manufacturing economy. In this section, each "Cost of Non-Europe" study is briefly reviewed.

The findings in *The "Cost of Non-Europe": Border Related Controls and Administrative Formalities,* by Ernst and Whinney (EW), aresubject to a range of assumptions and limitations imposed by the size and coverage of the sample and the extent official data were available. Although the results in this report should be treated with caution, they do represent the first attempt to obtain comprehensive empirical evidence on the customs costs of non-Europe. EW estimates that the costs to firms of customs procedures are about 7.5 billion ECU for administrative costs and fall into the range of 415 million to 830 million ECU for delay-related costs. The costs to government for administering the regulations amount to 500 million to 1,000 million ECU. On the question of increased trade, it is emphasized by EW that the estimates should be treated with particular caution. The study indicates that trade could rise anywhere from 0.75 billion to 15 billion ECU.

Table 2-2

Macroeconomic consequences of completing the internal market: EC as a whole in the medium term[1]

	Relative change		*Absolute change*		
Item	*As a percent of GDP*	*Consumer prices*	*Employment*	*General government borrowing requirement as a percent of GDP*	*External trade balance as a percent of GDP*
		Percent	*Millions*		
Frontier controls	0.4	(1.0)	0.20	0.2	0.2
Public procurement	0.5	(1.4)	0.35	0.3	0.1
Financial services	1.5	(1.4)	0.40	1.1	0.3
Supply effects	2.1	(2.3)	0.85	0.6	0.4
Total	4.5	(6.1)	1.80	2.2	1.0
Range	3.2 to 5.7	(4.5) to (7.7)	1.30 to 2.3	1.5 to 3.0	0.7 to 1.3

[1] Based on 1985 data.

Source: "The Economics of 1992."

In another study by Ernst and Whinney, *The "Cost of Non-Europe": An Illustration in the Road Haulage Sector,* the completion of the internal market is seen to have a profound impact on the road haulage industry. This industry represents the prime means of transporting goods between EC member states. In the current regime, vehicles are subject to delays either at frontiers or at inland clearance sites brought about by import and export formalities. Delays impose additional costs on the operator, and hence, raise the price of these services. The free movement and operation of road vehicles throughout the EC is restricted by a variety of measures, including (1) a quota system, which requires haulers to apply for quantitatively restricted permits in order to move goods to, from, and across member states, and (2) restrictions on nonresident haulers carrying out a collection and delivery within the boundaries of a member state. The findings of this study, subject to the assumptions and limitations imposed by the size of the sample, indicate that the total cost of delay due to customs controls is 415 million to 830 million ECU.

In the study *The Cost of "Non-Europe" in Public Sector Procurement* by W.S. Atkins Management Consultants, three primary effects are identified resulting from the EC 1992 initiative: a static trade effect, a competition effect, and a restructuring effect. In the short term, the static and competition effects are expected to predominate. The static trade effect results when products are bought from the cheapest supply country and represents trade based on comparative advantage. It is estimated for the five study countries (Belgium, France, West Germany, Italy, and the United Kingdom) that 3 billion to 8 billion ECU of new trade would result directly from opening public procurement and buying from the lowest cost provider. Note that this estimate includes 2 billion ECU in savings from purchasing coal outside the EC. Also in the short term, the competition effect will result from increased competition for national producers who are faced with foreign competitors for the first time. The increased competition will force protected suppliers to streamline their operations and cut costs, inducing an alignment of domestic suppliers' prices to those of the most competitive foreign suppliers. It is assumed that these price reductions can be met by reductions in real production costs, by investment in new technology, or by eliminating X-inefficiency. As a result of the dynamic effects of these competitive pressures on prices in sectors not previously open to international competition, 1 billion to 3 billion ECU should be saved for the five member countries studied in addition to the savings from static trade effects.

Technical barriers are examined by Groupe MAC in *Technical Barriers in the EC: An Illustration by Six Industries.* These barriers are viewed by most as one of the greatest obstacles to the completion of the internal market by 1992. Groupe MAC points out that all member countries have similar goals for protecting health, safety, and the environment. However, differences on how these goals should be achieved account for a large reason why technical trade barriers exist. Two additional reasons explain why certain technical barriers are difficult to remove. First, there is the protection of domestic special interests, and second, there is protection of what governments consider "strategic" industries. Groupe MAC notes that due to maneuvering by member states, the slow process of adopting EC directives, and uncertainties over legal recourse, technical barriers have been very difficult to remove. Eliminating technical barriers is expected to generate economic benefits to both producers and consumers throughout the EC. This study does not estimate the magnitude of the benefits.

The "Cost of Non-Europe": Obstacles to Transborder Business Activity by European Research Associates and Prognos (ERAP) attempts to quantify the economic costs incurred in transborder business activity (TBA) caused by divergent or discriminatory laws and regulations. TBA is defined by ERAP as any relationship between two firms in different countries linked in a long-term contractual relationship, each of which conducts at least two functions with some autonomy. The link is generally through equity holdings (i.e., a subsidiary) or a joint venture. The potential benefits of removing obstacles to TBA would be greater economies in management and production caused by the 1992 program. Some of the obstacles include discretionary application of national regulations, local-content requirements, different accounting practices, and differing tax policies. In this study it is estimated by ERAP that TBA obstacles result in a loss of 30 billion ECU as a whole for the EC.

The "Cost of Non-Europe" for Business Services by Peat Marwick McLintock (PMM) addresses liberalizing trade in business services. PMM notes that the corporate sector has for many years been in the process of externalizing services (i.e., contracting out services to specialist firms) largely because of the higher quality specialists can provide and, in some cases, because there are cost advantages. In contrast to the purchase of goods as inputs, firms are less likely to look abroad for business services. PMM found evidence of trade barriers for services, but these barriers are not recognized by users that tend to rely on domestic providers. Trade in most business services is low, even though most domestic markets are growing rapidly, a fact that hinders expansion of services and reduces the range of services provided to other countries. PMM estimates that barriers to service trade raise the cost of business services by 3.5 billion ECU. PMM contends that the use of external business

services is lower in a fragmented market, which in turn causes an overall efficiency loss to the economy of 0.3 billion ECU.

The study *The "Cost of Non-Europe" in Financial Services* by Price Waterhouse (PW) indicates that there are significant potential gains in completing the internal market in financial services. These gains are measured by PW in terms of consumer surplus[11] and economic welfare. PW estimates that the gain in consumer surplus would fall in the range of 11 billion to 33 billion ECU. PW argues that the midpoint of the above range (22 billion ECU) is an appropriate upper bound for the net gain in economic welfare. In addition, PW also estimates that gains from risk-pooling by capital markets could generate mean returns almost three-quarters as high as returns on existing portfolios. PW also sees potential gains resulting from the equalization of interest rates.

The report by the European Institute of Business Administration (INSEAD), *The Benefits of Completing the Internal Market for Telecommunications Services in the Community,* examines the issue of removing barriers to trade in telecommunications services. This issue is also specifically addressed in the EC's Green Paper on the development of the common market for telecommunications services and equipment (COM(87) 290 Final). The Green Paper was intended to establish a coherent EC-wide framework for the ongoing changes to the present system of telecommunications regulations. Telephone services, including voice, message, data, and image information, are generally provided by national telecommunication administrations (PTTs). Trade in telecommunications services does not normally take place. This study by INSEAD estimates the effect of regulatory reform of European telecommunications services. If 40 to 50 percent of public contracts are opened to international tender, as the Green Paper suggests, then savings from increased competition for these new contracts should allow the PTTs to lower tariffs. On the basis of extra traffic and network size effects, INSEAD estimates annual benefits amounting to 0.75 billion ECU. As certification is eased for new equipment, thus leading to an increase of new equipment available to consumers, INSEAD believes that the resulting effect will be an increase in telecommunications traffic. Moreover, this increase in traffic should be enhanced by greater terminal functions as the network becomes more integrated. The effects of increased traffic are estimated by INSEAD to result in economic gains of 0.25 billion to 0.50 billion ECU. As value-added network services are liberalized and "open network architecture" is adopted, it is estimated by INSEAD that gains of between 0.2 billion and 0.4 billion ECU will be realized.

In a companion study by INSEAD, *The Benefits of Completing the Internal Market for Telecommunications Equipment in the Community,* the EC objective of eliminating all current barriers to trade in telecommunications equipment is examined. The telecommunications equipment under consideration falls primarily into three categories: central-office equipment, switching equipment, and customer-premises equipment. To estimate the benefits of completing the internal market, INSEAD analyzes the determinants of the current industry structure. Moreover, price differences within the EC are compared to prices outside the EC. INSEAD assumes two possible levels of procurement liberalization, one at 40 percent and one at 100 percent. The gains from standardization (because of better exploitation of economies of scale) are estimated at 0.05 billion to 1.1 billion ECU. The additional gains from competitive procurement are estimated at 2.2 billion ECU under the 40-percent scenario and 3.7 billion ECU under the 100-percent scenario. Hence, totaling all effects, the benefits range from 3.05 billion ECU to 4.80 billion ECU depending on the degree of openness in the procurement market.

The research in *The EC 92 Automobile Sector* by Ludvigsen Associates, Ltd. (LA) indicates that there are relatively few instances of immediate direct effects from implementation of the 1992 program that are unique and distinctive to the automobile industry. LA argues that the principal effects are those that will be delayed in their implementation because they will only be realized after the industry has taken actions that the improved market conditions will facilitate. LA expects important cost reductions from improvements in production economies of scale that will occur when implementation of the 1992 provisions allow more extensive transborder interpenetration of individual parts, components, and assemblies. Variable cost savings are estimated by LA to be about 0.9 billion ECU. This estimate reflects the positive impact of improved labor productivity on variable costs. It is difficult to reduce variable costs in the industry, because the raw material content is high; labor represents only about 20 percent of variable costs. Fixed-cost savings are estimated by LA to be 1.7 billion ECU, thus indicating that this is the area likely to gain economies of scale after 1992. Combining fixed- and variable-cost savings results in a total savings of 2.6 billion ECU.

Trade barriers in the foodstuffs industry are examined by Groupe MAC in *The "Cost of Non-Europe" in the Foodstuffs Industry.* The goal of the 1992 integration in the foodstuffs

[11] Consumer surplus is the difference between the amount of money that the consumer is willing to pay for a given quantity of a good or service and the amount that the consumer actually pays.

industry is that any foodstuff produced and commercialized in one member country may be freely commercialized in any other member country. Nontariff barriers represent one of the main obstacles to this goal. This study identified 218 nontariff barriers in 10 product sectors. These barriers included 64 specific import restrictions, 14 fiscal discrimination measures, 68 packaging or labeling restrictions, 339 regulations on content, and 33 specific ingredient restrictions. Creating a single market in the foodstuffs industry will result in significant benefits. It is estimated by Groupe MAC that 0.5 billion to 1.0 billion ECU annually could be saved by liberalizing this industry. These benefits represent 2 to 3 percent of the total industry value added and correspond to a 1- to 2-year gain in productivity. However, Groupe MAC estimates that 80 percent of the benefits can be traced to the elimination of six barriers. On a case-by-case basis, it is predicted that some industry restructuring will occur (including consolidation among the largest firms), intra-EC trade will increase, and in a few cases extra-EC competitiveness will be enhanced.

Trade barriers in the Textile-Clothing (TC) industry are discussed by Breitenacher, Paba and Rossini (BPR) in *The "Cost of Non-Europe" in the Textile-Clothing Industry*. BPR contend that the impact of the 1992 market-integration program in the TC industry is not expected to be great. The TC industry has already been exposed to strong outside competition from low-wage countries. This fact makes it difficult to disentangle how much of the structural changes that may occur will be a result of extra- or intra-EC competition. BPR maintain that in the TC industry, plant and technical scale economies have already been achieved to a large extent. Moreover, they argue, the proportion of disposable income going to TC is not likely to increase, so the income effects of the internal market on consumption are going to be small. It is estimated in this study that the reduction of production costs should range between 0.5 and 1.5 percent. However, whether any of that savings will be passed on to consumers cannot be predicted. BPR believes that what is going to reshape the TC industry in the EC in the years to come is not the internal-market integration, but rather, competition from third countries.

The pharmaceutical industry is examined in *The "Cost of Non-Europe" in the Pharmaceutical Industry* by the Economics Advisory Group, Ltd. (EAG). This study notes that the supply of pharmaceuticals within the EC is highly internationalized. Taking the EC as a whole, EAG estimates that 43 percent of sales are by companies indigenous to their own national market. In every country the locally owned industry has a disproportionately large share of the local market. Only in France and West Germany, however, does it amount to over 50 percent. EAG also estimates that supplies from companies based in other EC countries make up a further 23 percent of the total, whereas 34 percent come from firms based outside the EC countries, primarily in the United States and Switzerland. The savings that might be expected from integration of the EC pharmaceutical market has been estimated by EAG in three scenarios that they believe are plausible. In the first, no concentration of facilities takes place, but economies due to unified and more rapid registration are realized. These economies are estimated to result in savings of between 160 million and 260 million ECU. In the second, multinationals also withdraw all production facilities from Greece and Portugal. This withdrawal is estimated to result in savings of between 204 million and 325 million ECU. In the third scenario, multinationals further reduce the number of formulation plants they operate by 50 percent in France and by 25 percent each in Italy and Spain. The production loss by these countries is transferred to West Germany and the United Kingdom. This transfer is estimated to result in savings of between 269 million and 533 million ECU. It is predicted by EAG that in the longer term unifying the European market will make the strong stronger and the weak weaker. Firms that have depended on the favor of their governments will suffer, whereas those that are already highly competitive will flourish even more. EAG believes that the elimination of marginal firms should concentrate resources with the more efficient firms and thus enable them to exploit the opportunities of the future. This study sees a two-tier pharmaceutical industry, in which firms are either very large or relatively small.

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CHAPTER 3
U.S. TRADE WITH THE EUROPEAN COMMUNITY

CONTENTS

Chapter 3

U.S. Trade With the European Community

Introduction

The European Community, defined by its 12 current member states, constitutes one of the largest trading partners of the United States (see app. E, tables E–1 and E–2). In terms of imports, the EC consistently accounted for between 18 and 20 percent of total U.S. imports during 1984–88, second to Japan, which ranked slightly higher during this period. In terms of U.S. exports, the EC has accounted for between 22 and 23 percent of the total during this same period and ranked as the largest market for U.S. exports during 1987 and 1988.

U.S. Trade with the EC

U.S. trade balance

The U.S. trade balance for all commodities traded between the United States and the EC was a deficit of $11.5 billion in 1984. This deficit increased to $12.7 billion in 1988. Overall the trade deficit increased by about 11 percent from 1984 to 1988. This increase follows the trend in the total U.S. trade balance with the world, which has increased from about $106 billion in 1984 to $129 billion in 1988, representing an overall increase of 22 percent.

The individual SITC divisions that provide the largest impact on the current trade balance are shown in table E–3. U.S. exports of Office Machines and Automatic Data Processing Equipment (SITC division 75) dramatically exceeded imports and provided the greatest positive balance with the EC in 1988—$8.2 billion. Other divisions, primarily manufactured goods, provided positive, although somewhat lower trade balances in 1988. The greatest deficit, however, was for Road Vehicles (SITC division 78), primarily because of the large value of standard and luxury automobiles imported from the EC.

U.S. exports

U.S. exports to all markets amounted to $308 billion in 1988, up 42 percent from a level of $217 billion in 1984 (table E–1). The EC as a unit accounted for approximately 22 percent of total exports during 1984 and 1985, and this trend increased slightly, to 23 percent, during 1986–88. In terms of value, the EC has made up the most significant export market.

The largest categories of exports from the United States to the EC in 1988 include Office Machines and Automatic Data Processing Equipment; Other Transport Equipment, which includes rail coaches, airplanes, and ships; Electrical Machinery, Apparatus and Appliances; Power Generating Machinery and Equipment; and Professional, Scientific and Controlling Instruments and Apparatus (SITC divisions 75, 79, 77, 71, and 87, respectively; tables E–4 to E–14).

Total exports for these top 5 SITC divisions in 1988 were $28.5 billion, representing 40 percent of total U.S. exports to the EC countries. Primary markets for U.S. exports in 1988 among EC nations were the United Kingdom, 24 percent; West Germany, 18 percent; and the Netherlands, 13 percent. Other major markets for U.S. exports were Canada, accounting for 21 percent of the total, and Japan, representing about 12 percent.

The largest SITC division grouping for U.S. exports to the EC was Office Machines and Automatic Data Processing Equipment (SITC division 75). Exports to the EC in this category increased by 57 percent, from $6.7 billion in 1984 to $10.5 billion in 1988, largely due to increased demand for data processing equipment and computers. The largest market for division 75 within the EC was the United Kingdom. Although data are not available for 1988, it is estimated that the EC nations obtained about 15 percent by value of total EC imports from the United States, and the remaining trade was made up principally of imports from other EC member states.

The second-largest export SITC category was Other Transport Equipment (SITC division 79), which includes railway and tramway vehicles, aircraft, and ships. Total U.S. exports increased from $12 billion in 1984 to $21 billion in 1988. Although this represents an increase of 78 percent by value, exports to the EC as a unit rose by nearly 125 percent, from $2.8 billion in 1984 to $6.4 billion in 1988. The EC accounted for nearly 30 percent of U.S. exports in this category in 1988. By contrast, Canada and Japan collectively accounted for 17.4 percent in that year. The United Kingdom and West Germany accounted for over 50 percent of the market for U.S. exports to the EC under this category and 15.1 percent of all U.S. exports. Estimated data for 1988 indicate that the EC obtained only about 4 percent of its imports in this category from the United States, with the remainder obtained principally from inter-EC-country trade.

The third-largest category of exports to the EC in 1988 was Electrical Machinery, Apparatus and Appliances (SITC division 77). Total U.S. exports in this division amounted to $21.3 billion in 1988, and exports to the EC amounted to $3.2 billion. This amount represents a 50-percent increase from $2.1 billion exported in 1984. Estimated data for 1988 show that the EC obtained a large portion of EC imports in this category principally from inter-EC-country trade,

whereas only about 11 percent was obtained from the United States.

U.S. imports

The 5 largest SITC commodity groupings of U.S. imports from the EC were Road Vehicles; Machinery Specialized for Particular Industries; Miscellaneous Manufactured Articles; Electrical Machinery, Apparatus and Appliances; and General Industrial Machinery and Equipment (SITC divisions 78, 72, 89, 77, and 74, respectively). These five groupings accounted for $30.4 billion in 1988, or 36 percent of total U.S. imports from the EC. These same five groupings accounted for 35 percent or $153 billion of total U.S. imports of $437 billion from all countries in that year (tables E–15 to E–25).

U.S. imports of Road Vehicles, as defined by SITC division 78, amounted to $75.9 billion in 1988, increasing by 60 percent, from $47 billion in 1984. Total imports from the EC amounted to $11.2 billion in 1988, or about 15 percent of the total form the world. Imports from the EC in this category increased by 46 percent during the period. The largest supplier in the EC was West Germany, which supplied about $7.8 billion in 1988, or 69 percent of U.S. imports from the EC. Only about 13 percent of EC exports in SITC 78 was supplied to the United States; the remainder was supplied principally to other EC member states.

The second-largest area of imports from the EC in 1988 was Machinery Specialized for Particular Industries (SITC division 72). Specific products and product groupings included in SITC 72 are agricultural machinery; lawnmowers; construction vehicles such as bulldozers, excavators and mechanical shovels; industrial machinery for producing textiles, including spinning, weaving, knitting, and washing machines; and other machines related to the manufacture of paper. Total imports from the world under SITC 72 amounted to $7.5 billion in 1984 and increased by 75 percent, to $13.1 billion in 1988. The EC supplied $6.2 billion, or 47 percent of the total, in 1988. This figure accounts for only about 11 percent of total EC exports in division 72, on the basis of estimated data for 1988. The remainder of EC exports is made up principally of inter-EC-country trade.

Miscellaneous Manufactured Articles (SITC division 89), which includes such products as miscellaneous printed materials, office supplies, jewelry, musical instruments, and other miscellaneous manufactured articles, formed the third-largest category of imports from the EC in 1988. Total U.S. imports under division 89 amounted to $21 billion. Imports from the EC grew from $3.2 billion, or 14 percent of total imports in this category, in 1984 to $4.7 billion, or 20 percent of total imports, in 1988. Italy and the United Kingdom supplied nearly 56 percent of imports from the EC in 1988. On the basis of estimated data for 1988, the EC only supplied about 11 to 12 percent of those exports to the United States. The remaining EC exports in this SITC division were traded principally in inter-EC-country trade.

EC Trade

EC world trade

Exports of the EC member states, as a group, amounted to about $951 billion in 1987, according to official U.N. statistics (table E–26). Total exports rose evenly over 1984–87, resulting in an average increase of about 19 percent per year. The largest markets for EC exports, in order of importance, were West Germany, France, the United States, the United Kingdom, and Italy. About 65 percent of inter-EC-country trade in 1987 was with the top four ranking EC members. The United States constituted about 8.5 percent of the total market for EC exports in 1987.

Total imports into the EC amounted to about $950 billion in 1987, reflecting average annual increases of about 17 percent during 1984–87 (table E–32). Total imports increased the most from 1987 to 1988, by more than 22 percent. Principal suppliers to the EC from all sources, in order of importance, were principally EC member states, including West Germany, France, and the Netherlands. The United States ranked fourth as a major world supplier to the EC and was the only non-EC supplier ranked in the top five sources as a supplier to the EC. In 1987, about 6.8 percent of total EC imports came from the United States.

The SITC divisions in which the EC has the largest trade with all countries, are Non-electric Machinery; Transport Equipment; Electrical Machinery; Petroleum and Petroleum Products; and Chemical Elements and Compounds (SITC divisions 71, 73, 72, 33, and 51, respectively; tables E–27 to E–31 and tables E–33 through E–37).

EC external trade

International external trade, excluding inter-EC-country trade, provided somewhat different trade patterns during the period 1984–87 (tables E–38 and E–44). Total exports external to the EC member states amounted to $394 billion in 1987, increasing by an average of 14 percent per year since 1984. Principal external markets for the EC in 1987 were the United States and other European (but non-EC) countries, including Switzerland, Austria, and Sweden. The fifth-largest external market for EC exports was Japan. Exports to the United States amounted to approximately $81 billion in 1987, or about 21 percent of total external exports. Exports to Switzerland, Austria, and Sweden

together also accounted for 21 percent of total EC external exports in 1987. Exports to Japan amounted to almost $16 billion in 1987, or only about 4 percent of total EC external exports.

The top ranking SITC export category in 1987 was Nonelectric Machinery (SITC div. 71). Exports increased evenly from about $46 billion in 1984 to $72 billion in 1987, resulting in an average annual increase of about 20 percent. The principal market for exports within this division in 1987 was the United States, amounting to some $16 billion, or about 22 percent of the total, followed by Switzerland, Sweden, and Austria (table E-39).

Other top export categories in 1987 were, in order of importance, SITC division 73, $54 billion; SITC division 72, $35 billion; SITC division 89, $18 billion; and SITC division 51, $18 billion (tables E-40 to E-43). The United States was the leading market for all of the top five SITC divisions.

Total imports from sources external to the EC amounted to approximately $399 billion in 1987. Imports increased by an average of about 10 percent annually since 1984. The leading supplier of external imports to the EC in 1987 was the United States. Imports from the United States in that year reached $65 billion, or about 16 percent of the total. Other major suppliers included Japan, which supplied a level of $42 billion, or 11 percent; and other non-EC European sources, including Switzerland, Austria, and Sweden, which together supplied about 17 percent of total EC external imports.

The leading SITC division for EC external imports was SITC 33, Petroleum and Petroleum Products, amounting to about $56 billion in 1987. The EC is generally dependent on imports of petroleum, as is the United States, although the top sources for EC imports of petroleum and products included the Soviet Union, Saudi Arabia, Libya, Norway, Iraq, and Iran. Imports of this SITC division dropped from about $84 billion in 1984 to about $56 billion in 1987, corresponding to a decrease of almost 33 percent. Imports from the Soviet Union, the largest supplier, recorded the greatest decrease, from over $12 billion in 1984 to $7.8 billion in 1987, or by 35 percent, and imports from Iraq, Iran, and Norway remained nearly level (table E-45).

Other top import categories in 1987, in order of importance, were SITC division 71, $47 billion; division 72, $33 billion; and division 73, $25 billion (tables E-46 to E-49). The United States, Japan, and Switzerland were the top 3 sources for goods imported under SITC divisions 71 and 72. Japan was the leading source of transport equipment classified under SITC division 73, and the United States was ranked second. SITC division 89 was the fifth-largest category of EC external imports in 1987, reaching a level of nearly $19 billion. Leading suppliers, in order of importance, were Japan, the United States, and Switzerland, which together accounted for 57 percent of total imports in that year.

PART II
ANTICIPATED CHANGES IN THE EC AND POTENTIAL EFFECTS ON THE UNITED STATES

This section, chapters 4 to 12, accounted for the major share of the resources used on the study. The following paragraphs explain what is and is not covered by the section and how the section differs from other writings on EC 92. The section generally sets the stage for what is to follow in the individual section chapters.

In June 1985, the EC Commission issued a White Paper outlining approximately 280 directives intended to complete the internal market of the EC by December 31, 1992. USITC investigation No. 332-267 examined all of the approximately 220 White Paper directives that were proposed by the EC Commission as of December 31, 1988. The majority of the 220 directives that were proposed by the EC Commission were also approved by the EC Council of Ministers. When a directive that was proposed as of December 31, 1988, was modified following that date, the more recent version of the directive was noted in this study provided text was available as of June 30, 1989.

In this investigation, the USITC does not attempt to predict the progress of proposed directives in the approval and implementation stages. Nor does the USITC predict how proposed directives might be amended. Instead, it is assumed that proposed directives are implemented as proposed.

In addition to proposed directives, the investigation has examined some 35 EC Commission decisions, recommendations, and regulations that are associated with the program to complete the internal market. These measures differ from one another and from directives in various ways including the degree to which an action by the EC is binding on member states. For instance, a regulation is essentially self-implementing, whereas an EC directive is implemented by each member state through alteration in member-state law. The investigation has also examined certain relevant decisions by the European Court of Justice. EC initiatives or developments that do not directly affect the program outlined in the White Paper to complete the internal market are not included in this study.

Because of the December 31, 1988, cutoff point, this investigation gives less emphasis to certain subjects than is the case in some other studies of the EC 1992 exercise. For instance, nearly all observers agree that the area of pharmaceuticals seems likely to be affected significantly by the EC 1992 exercise. However, some of the more important EC initiatives in the pharmaceuticals area have not yet been proposed by the EC Commission. Hence, the subject necessarily receives less analysis in the current investigation than is the case in some other studies of EC 1992.

The EC initiatives that are examined most carefully are those that seem potentially more significant for U.S. commercial interests. Because initiatives differ greatly from one to another, there is no reliable way to make quantitative comparisons of the potential effects of different initiatives.

In this investigation, EC initiatives are examined more closely if they include one or both of the following elements:

1. A significant change in the EC regarding a product or service that the U.S. exports to the EC in large quantity.

2. A significant change in the EC regarding a product or service that U.S. facilities in the EC currently provide in large quantity.

The initiatives are organized into categories depending on the nature of the initiative (e.g., whether it affects product standards, customs regulations, etc.) These categories are as follows:

- Government Procurement
- Financial Sector
- Standards
- Customs Controls

- Transport
- Competition and Corporate Structure
- Taxation
- Residual Quantitative Restrictions
- Intellectual Property

Note that these categories were selected by the staff of the USITC and are not official EC designations. Likewise, the allocation of particular initiatives to specific categories is based on staff analysis and may differ from allocations by the EC Commission or other organizations or individuals.

The quantitative restrictions category is the one area in which this investigation departs from the policy of avoiding prediction of future events in the EC. If the EC succeeds in removing internal barriers to trade, it will become more difficult to monitor national quantitative restrictions. The EC would therefore be likely to eventually move forward with an initiative regarding the use of national quantitative restrictions. To permit analysis of potential effects on the United States, USITC staff assumed a hypothetical EC directive in the area of quantitative restrictions.

CHAPTER 4
GOVERNMENT PROCUREMENT

CONTENTS

CONTENTS—*Continued*

CONTENTS—*Continued*

CONTENTS—*Continued*

Chapter 4

Government Procurement

The EC public sector represents a large and potentially crucial market for a number of U.S. industries. To date, however, U.S. suppliers have had limited success in selling to government purchasers in the EC member states. As part of the 1992 program, public sector contracts will become subject to EC-wide rules intended to introduce greater openness, transparency, and nondiscrimination in all phases of contract-award procedures. If successfully implemented, these rules could encourage competition and provide increased opportunities for U.S. firms. However, U.S. suppliers are concerned about some aspects of the EC's procurement proposals, fearing that they may lead to discrimination against non-EC suppliers, a loss of existing sales to EC public purchasers, and unwanted changes in sourcing patterns. This chapter discusses how government procurement procedures will change as a result of the 1992 program, the possible effects of those changes on the United States, and their impact on particular U.S. industries identified as potentially affected.

Background

As part of the 1992 program, the EC will establish common codes of conduct and road maps of procedures to be followed by each of the 12 member states in their government purchasing. The new rules will affect each step of contract-award procedures. Not only will existing rules be strengthened and made more uniform, sectors such as telecommunications and energy—which have to date remained the protected domain of "national champion" supplier firms—will become subject to formal EC-wide rules for the first time.

Why Procurement Procedures Matter

Putting in place formal procurement procedures is considered a necessary condition for ensuring fair treatment of U.S. and other foreign suppliers in the EC market.[1] The desirability of such rules is illustrated by the record of defense-related procurement in the EC. The U.S. Department of Defense has signed memorandums of understanding with all of the United States' NATO allies—including with the individual EC member states—that provide assurances that U.S. suppliers will be accorded reciprocal treatment. However, the memorandums do not require that specific procedures be put in place to back up that pledge.

According to the U.S. Department of Commerce, U.S. suppliers regularly complain that they are not notified of upcoming defense-related contracts in the EC; that they are apprised of whom to contact to find out what procurement plans are; that they do not participate in, nor have access to, the drafting of bid specifications; that they are often unable to prepare responsive bids because time limits are too short or tender documentation is not forthcoming; that they do not have regular opportunities to prove their capabilities to EC public purchasers; and that should they complain, they are often forced to deal with the same individuals who discriminated against them in the first place.[2]

The U.S. Stake

Access to the EC public sector market is vital to a number of U.S. industries. Public purchasers in the European Community reportedly account for 90 percent of U.S. telecommunications equipment sales in the EC and up to one-third of the sales by major U.S. computer and office machine manufacturers.[3] EC governments are also significant purchasers of data processing services and medical equipment. In some product areas, such as power generators and water treatment equipment, public utilities are the most important potential EC customers for U.S. firms.

Total public procurement in the EC was an estimated $351.3 billion in 1987. The United Kingdom ($80.6 billion), Germany ($75.0 billion), France ($68.6 billion), and Italy ($53.8 billion) were the EC's largest public purchasers (See fig. 4-1). However, U.S. suppliers do not have ensured access to nearly half of this procurement because it has been removed from the scope of EC and international trading rules.

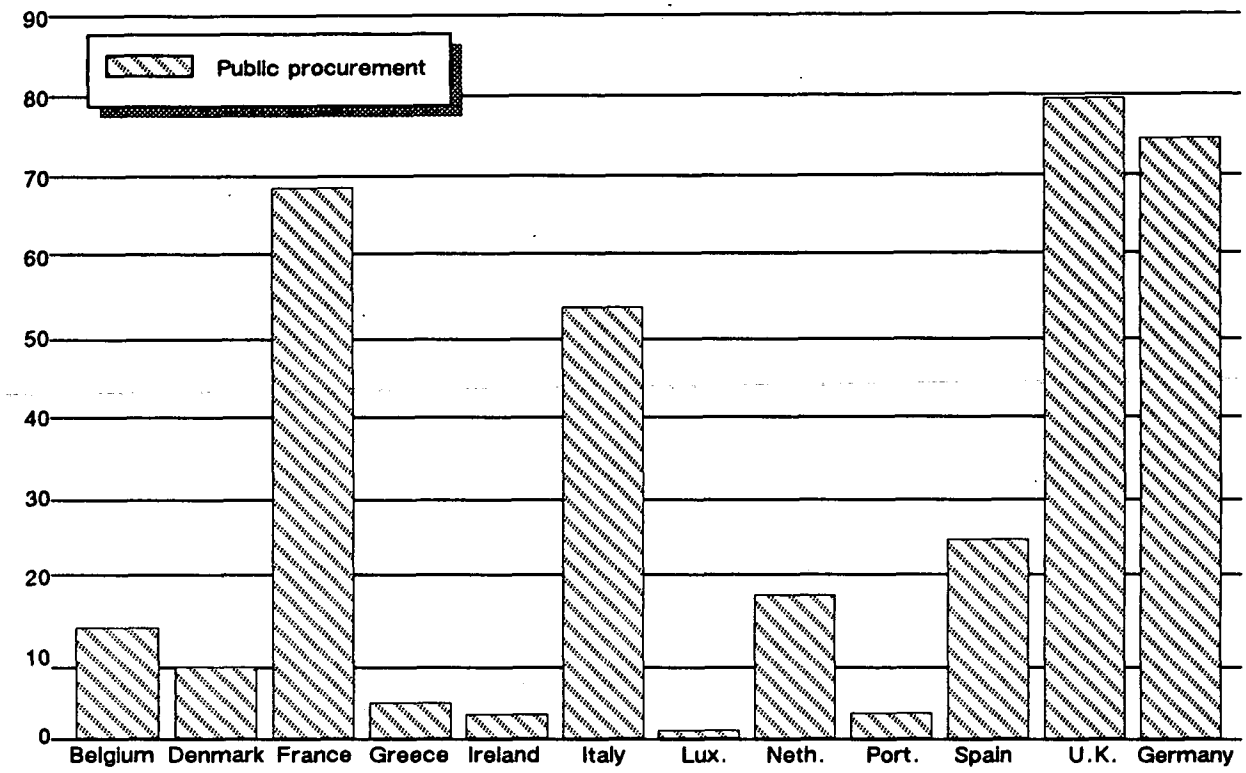
Harmonizing the various member-state public procurement laws, regulations, and practices and introducing formal procedures could make it easier for foreign suppliers to compete for EC public sector contracts, because the same fundamental principles and procedural ground rules will be in effect in all 12 member states. Rules that were previously vague and loosely worded will be more specific and detailed, making them easier to interpret and less likely to be circumvented. Member-state obligations and rights will be more clearly defined, and enforcement of such rights made tougher, both at the national and at the EC level.

[1] The U.S. Department of Commerce reports that two conditions must be present in order for a foreign market to be considered by the U.S. Government as open to U.S. suppliers: (1) a formal commitment to treat U.S. suppliers in a nondiscriminatory manner and (2) a formal set of procurement procedures covering each stage of the procurement process. USITC staff interview, June 6, 1989.

[2] USITC staff interview with Office of Multilateral Affairs, U.S. Department of Commerce, June 6, 1989.

[3] USITC staff interview with the American Chamber of Commerce in Brussels, Feb. 26, 1989.

Figure 4-1
EC-12 public sector procurement, 1987



Source: W.S. Watkins Management Consultants, *The Cost of Non-Europe in Public Sector Procurement*, (Luxembourg: Office of Official Publications of the European Communities, [1988]).

Whether U.S. suppliers will actually benefit from the EC's proposed procurement directives depends to a large extent on how fully the member states implement them and on how vigorously the EC Commission and the European Court of Justice enforce them. The procurement directives still leave procuring officials with substantial administrative discretion. Access for nonnational suppliers, including those from the United States, is far from guaranteed. Faced with a record of past discrimination and unproven avenues for access in the future, U.S. suppliers, already confronting substantial legal, language, and technical barriers, may calculate that such steps would be a waste of time and money and decide not to bid on contracts or avail themselves of redress mechanisms. On the other hand, U.S. suppliers are well placed to benefit if the directives do move EC public purchasing in the direction of greater openness. U.S. firms have strong international positions in many of the sectors expected to be most directly affected. Moreover, current industry trends may support the goal of more globally oriented procurement in the EC.

Previous EC Efforts to Open Public Sector Procurement

Leaders in the European Community have long recognized the benefit of opening up member-state government procurement to greater competition. This huge sector of the economy—estimated at an average of 9 percent of national GDP if only contracts placed by central and local government are considered, and as much as 15 percent of GDP if nationalized industries are included[4]—traditionally has been dominated by "buy national" policies, short-term thinking, and protection of special interests, according to the EC Commission.[5] Opening such

[4] Paolo Cecchini, *The European Challenge 1992: The Benefits of a Single Market*, (Aldershot, England: Gower Publishing Company, Lid., 1988), p. 16.
[5] Commission of the European Communities, "Guide to the Community Rules on Open Government Procurement," *O.J.* No. C 358 (Dec. 31, 1987), p. 5.

contracts up to greater competition could encourage restructuring and modernization of EC industry over the longer term and result in immediate, substantial budgetary savings.

The EC adopted two directives in the 1970s that required specified entities at the national, regional, and local levels to employ transparent, nondiscriminatory procedures in procurement. These actions had the effect of establishing formal, EC-wide disciplines in the area of government procurement, a necessary step if predictability of treatment for foreign firms is to be achieved.

The EC adopted the so-called "works" directive (71/305) in 1971 in an effort to open up member-state contracts for public works construction.[6] Entities listed in the annex to the directive are required to follow certain procedures for announcing and awarding contracts above a threshold of 1 million ECU.[7] In 1977, the EC adopted the original "supplies" directive, which required specified entities at the national, regional, and local levels to employ transparent, nondiscriminatory procedures for procurement of goods worth 200,000 ECU and above, whether by purchase, lease, or rental.

Both the supplies and the works directives commit covered entities to use objective, nondiscriminatory criteria in tendering and awards. Contracting authorities may elect to use either the open procedure, in which the contract is publicly announced and all interested suppliers are permitted to bid, or the restricted procedure, which is open only to selected potential suppliers or contractors. In specified exceptional circumstances, the authority is permitted to forego tendering and directly negotiate with one or several suppliers, commonly referred to as "noncompetitive-" or "single-tendering procedures." Both restricted and single-tender procedures sometimes involve the negotiation of actual contract terms with potential suppliers.

In each instance, however, specific procedural guarantees are provided in an effort to make procurement decisions more predictable and fair. For example, contracts must be advertised in the *Official Journal*, time limits for each stage of the award procedure are set, and procuring officials are required to treat suppliers from other EC members on an equal footing with domestic bidders.

Subsequently, the EC joined the Tokyo Round Agreement on Government Procurement (the Government Procurement Code), to which the United States is also a signatory. The amending supplies directive, 80/767 of July 22, 1980, implemented the GATT agreement and extended the terms of the GATT Code to EC suppliers.[8] To simplify, the GATT Government Procurement Code and the EC supplies directive impose the same obligations on central-government ministries in the member states, since the revised supplies directive gives practical force to the EC's obligations under the GATT Government Procurement Code.[9]

Nevertheless, progress in opening up public sector opportunities in the EC has been minimal to date. Actual levels of procurement from nonnational suppliers remain low in all EC member states. Indeed, several studies estimate that EC member states, on average, procure less than 2 percent of government needs from nonnational suppliers, including purchases from other EC members.[10] According to one estimate, 75 percent of goverment needs are awarded to "national champions" for whom the tenders are tailor made.[11]

The low level of public sector imports has been attributed to a variety of factors, including the following:[12]

[6] The directive applies to "public works contracts," defined in art. 1 as contracts for pecuniary consideration concluded in writing between a contractor and an authority awarding contracts concerning one of the activities in the construction sector listed in major group 40 of the "nomenclature for industries in the European Communities" and listed in an annex to the directive 71/305.

[7] The authorities covered include state, regional, or local authorities and legal persons governed by public law in the member states. The directive excludes from its scope public works contracts awarded by "bodies which are governed by public law and which administer transport services" (art. 3.4) or which are engaged in "the production, distribution, transmission, or transportation services for water and energy." (art. 3.5) Some entities in the telecommunications sector are, apparently, obliged to follow the directives procedures. The directive also excluded "concession contracts," and contracts awarded under an international treaty with one or more nonmember countries, including those under an international agreement relating to the stationing of troops.

[8] Specifically, directive 80/767 lowered the value threshold and extended the directive's coverage to a fairly exhaustive list of central-government ministerial departments, subministerial departments, and government institutions in the member states. Signatories to the code were not guaranteed the right to compete for lease or rental contracts in EC member states, nor the right to compete for contracts by entities not specifically listed in the annex to the code. Regional and local authorities in the member states are generally not obliged to follow the GATT Government Procurement Code rules. Contracting authorities in the field of defense are only obliged to follow open procedures for products listed in annex II to directive 80/767.

[9] See part III for a discussion of the obligations contained in the GATT Agreement on Government Procurement.

[10] Paolo Cecchini, *The European Challenge 1992: The Benefits of a Single Market*, (Aldershot, England; Gower Publishing Company, Ltd., 1988) and W.S. Atkins Management Consultants, *The Cost of Non-Europe in Public Sector Procurement* (Luxembourg: Commission of the European Communities, 1988).

[11] Commission of the European Communities, *Second Report From the Commission to the Council and the European Parliament on the Implementation of the Commission's White Paper on Completing the Internal Market*, COM (87) 203, (May 11, 1987), p. 16.

[12] Commission of the European Communities, "Guide to the Community Rules on Open Government Procurement," *O.J.* No. C 358 (Dec. 31, 1987), p. 5.

(1) *Failure to adequately implement prior directives.* Some member states have not translated EC directives into national laws or developed appropriate administrative procedures.

(2) *Bureaucratic attempts to frustrate the objectives of prior directives.* Examples include failure to publicly notify potential suppliers of opportunities to bid, breaking up of contracts to bring them below the applicable thresholds, use of discriminatory qualification criteria, incorporation of technical specifications that favor national suppliers, and abuse of administrative discretion in choosing procurement methods and making contract awards.

(3) *Lack of effective enforcement mechanisms.* Although some member states provide administrative or judicial remedies to disgruntled suppliers, others do not. Even if such mechanisms exist, they are widely perceived as being slow and lacking "teeth."

(4) *Removal of important entities, services and products from coverage.* Most services, national security-type products, and entities in the telecommunications, energy, transportation, and water sectors, were removed from the scope of EC discipline (see fig.4-2).

Differences in the nature of public procurement from one member state to another have also played a role in the low level of nonnational procurement. In some member states, the procurement system is highly developed and centralized at the national level. In others, purchasing is decentralized. Average contract values consequently are low, and purchasing departments often do not have the resources to attract and assess foreign bids.[13]

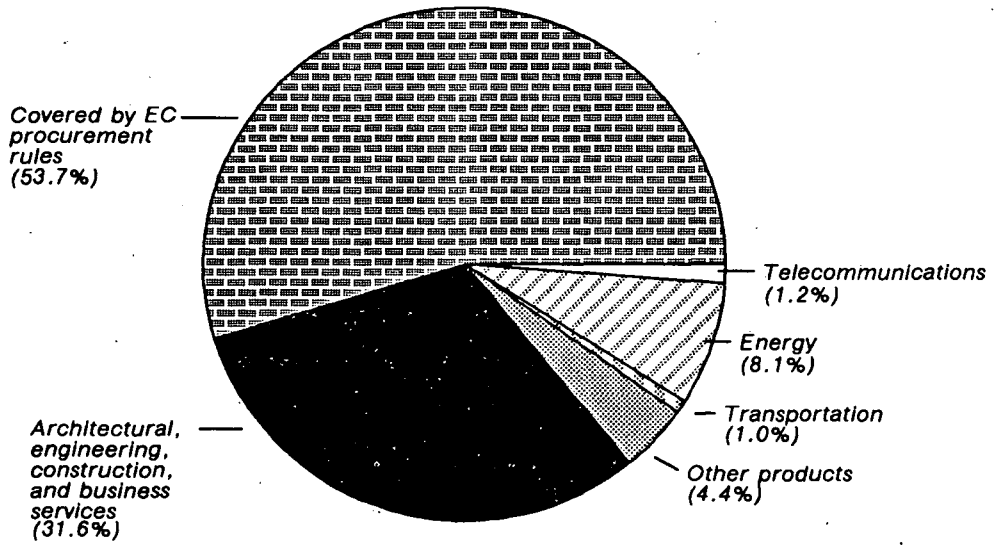
Anticipated Changes

The EC Commission envisions a substantial strengthening of existing member-state commitments on public procurement as part of the 1992 program. The 1985 White Paper proposes a legislative program running through 1990, with member-state implementation of all directives by 1992. Basically, the legislation envisaged would—

- Close loopholes in existing directives;
- Expand the scope of EC discipline to cover most entities in the so-called "excluded sectors" and services contracts;
- Require member states to provide effective administrative and judicial remedies for wronged suppliers; and
- Strengthen EC oversight of member-state procurement practices.

[13] It should be noted that centralizing control over procurement practices may also make it easier for countries to use public procurement as an instrument of public policy, particularly industrial and social policy.

Figure 4-2
EC public procurement, covered and not presently covered by EC procurement rules, in 1987



Source: W.S. Watkins Management Consultants, *The Cost of Non-Europe in Public Sector Procurement*, Luxembourg: Office for Official Publications of the European Communities, 1988.

Since 1985, the EC Commission has proposed five directives intended to rectify the closed nature of member-state procurement. The five directives proposed as of December 31, 1988, cover (1) "supplies"; (2) "works"; (3) "remedies"; (4) energy, transport, and water; and (5) telecommunications. One of those directives—"supplies"—has been adopted. A services directive is reportedly under preparation, slated for submission to the Parliament in mid-1989. A separate directive on remedies for the excluded sectors is also likely to be developed. A description of each of the formally proposed directives follows.

Supplies

The EC has achieved a major revamping of the "supplies" directive as part of the 1992 program. The changes adopted are intended to rectify problems in member-state implementation of the original supplies directive, and they reflect the EC Commission's identification of points of procurement process where discrimination is most likely to occur. The amending directive also implements the EC's commitments made in the context of the 1986 renegotiation of the GATT Government Procurement Code.[14]

The new supplies directive, 88/295,[15] amends the 1977 supplies directive in an effort to—

- increase the transparency of procedures and practices for the award of public supply contracts;
- make application of these procedures more widespread by more narrowly defining the instances in which entities may avoid EC requirements to publicly announce tenders and to award contracts in a nondiscriminatory manner;
- improve the availability of information about procurement decisions in order to make stricter enforcement of EC directives possible;
- support the EC's efforts to break down standards-related barriers to trade in industrial products and encourage mutual recognition of professional qualifications; and[16]

The main amendments—

- close loopholes in the previous directive by, for example, clarifying the method for calculating the value of contracts for purposes of applying the thresholds and more narrowly defining "the excluded sectors"[17] and national-security-type exemptions;[18]
- tighten up conditions under which noncompetitive tendering can be employed. Entities are only permitted to use noncompetitive procedures under specified circumstances, and in all cases, must complete a written report documenting the necessity for resorting to such procedures;[19]
- increase transparency by requiring covered entities to (1) publish their projected annual procurement programs and timetables at regular intervals;[20] (2) publish a notice giving details of the outcome of procurement decisions, including winning supplier and general contract terms; (3) transmit a statistical report to the EC Commission by June 30 relating to contracts awarded in the previous year; and
- promote competition by (1) lengthening the minimum time limits for submission of bids or applications to bid;[21] and (2) requiring

[14] Namely, directive 88/295 lowers the threshold for procurements covered by directive 80/767 to 130,000 ECU and enables code signatories to compete for leasing or rental contracts by EC entities listed in the annex to directive 80/767. As a result, thresholds above which EC Commission rules apply are basically 200,000 ECU for regional and local procurement and 130,000 ECU for central-government procurement. (Central-government procurement in the EC is generally covered by the GATT Government Procurement Code.)

[15] The directive was published in *O.J.* No. L 127, (May 20, 1988), pp. 1 to 14; previous EC legislation on this matter is found in directive 77/62, *O.J.* No. L 13, (Jan. 15, 1977); Directive 80/767, *O.J.* No. L 215, (Aug. 18, 1980).

[16] See Commission of the European Communities, "Guide to Community Rules on Open Government Procurement," *O.J.* No. C 358 (Dec. 31, 1987), p. 2.

[17] Directive 88/295 replaces the definition of "excluded sectors" contained in the 1977 directive with the following: "Art. 2: This Directive shall not apply to: (a) public supply contracts awarded by carriers by land, air, sea, or inland waterway; (b) public supply contracts awarded by contracting authorities in so far as those contracts concern the production, transport and distribution of drinking water or those contracting authorities whose principal activity lies in the production and distribution of energy, nor to those contracting authorities whose principal activity is to offer telecommunications services; (c) supplies which are declared secret or when their delivery must be accompanied by special security measures in accordance with the laws, regulations, or administrative provisions in force in the Member State concerned or when the protection of the basic interests of that State's security so require." (art. 3 of 88/295).

[18] For this purpose, directive 88/295 clarifies the instances in which procurements are not required to undergo normal competitive procedures on the grounds of national security, particularly by entities in the field of defense, by inserting a new art. 2A clarifying that the directive applies to the procurement of all supplies, except those to which provisions art. 223 (1) (b) of the Treaty of Rome apply, i.e., arms, munitions, and war materiel.

[19] Directive 80/767 required entities subject to the Government Procurement Code to prepare such reports whenever noncompetitive procedures were used and to transmit them to the EC Commission upon its request.

[20] The new art. 9, par. 1 states, "[C]ontracting authorities listed in Annex I to Directive 80/767 shall make known, as from 1 January 1989 . . . by means of an indicative notice, the total procurement by product area of which the estimated value . . . is equal or greater than 750,000 ECU and which they envisage awarding during the coming 12 months."

[21] Per the 1986 renegotiation of the GATT Government Procurement Code, these longer time limits will also apply to procurement covered by directive 80/767.

entities to refer to EC-wide standards, where they exist, unless the use of such standards would result in disproportionate costs or technical difficulties.[22]

The directive allows member states to retain preferences intended to reduce regional and economic disparities until December 31, 1992, provided those preferences are consistent with the EC's international obligations and the provisions of the Treaty of Rome. The directive was adopted on March 22, 1988, and most member states were to comply by January 1, 1989; Greece, Spain, and Portugal are to comply by March 1, 1992. Most member states reportedly have already incorporated the directive into national legislation.

Works

Public works account for more than 30 percent of total public sector purchasing in the EC. Despite previous efforts to eliminate procedural discrimination and improve transparency, public works contracts in the EC remain nearly the exclusive domain of national contractors. As part of the 1992 program, the EC has proposed a major rewriting of the original works directive in an effort to introduce greater competition in the EC construction market.

The EC's new works directive was initially proposed on January 12, 1987,[23] and modified on June 20, 1988, following the opinion of the European Parliament. Formal adoption by the Council is expected on July 18, 1989. The directive[24] is intended to open up bidding on major public works projects to companies based anywhere in the EC. It also raises the value threshold from which contracts become subject to the rules from 1 million to 5 million ECU.[25] The directive has important implications for suppliers of construction products, as well as for providers of architectural, engineering, and construction services, because public entities in the EC will be required to use European standards in tender documentation.[26]

The main amendments to the 1971 directive would—

- extend the scope of the 1971 directive by more broadly defining the entities awarding contracts that are subject to the directive. Specifically, the directive (1) extends the scope of the previous legislation to cover contractual forms that has developed over the past decade;[27] (2) includes contracts awarded by entities financed from public funds; (3) adopts a more limited definition of the exclusion of entities in the water, energy, and transport sectors, similar to that in the revised "supplies" directive;
- narrow the instances in which competitive tendering rules may be waived and require entities to provide written justifications to the EC Commission when noncompetitive procedures are used. The former noncompetitive procedure has been replaced with a negotiated procedure, and the directive establishes the principle of advertising and objective preselection of potential suppliers in negotiated tenders;
- enable contractors to more easily bid for contracts by (1) introducing advance advertising of construction projects to be put out to tender within the coming 6 to 12 months; (2) lengthening the minimum time limits authorities allowed for bids and applications to bid; (3) requiring entities to refer to EC standards, when they exist, in tender documents and to allow greater scope for technologically advanced solutions and more economically advantageous pricing methods; and[28]
- increase the transparency of tendering and award procedures by requiring authorities to document their decisions and actions.

[22] European standards are defined in annex II to the directive as, "Standards approved by the European Committee for Standardization (CEN) or by the European Committee for Electrotechnical Standardization (CENELEC) as 'European Standards (EN)' or 'Harmonization Documents'(HD) according to the Common rules of these organizations." Entities are required to record the reasons for using non-EC standards and, under such circumstances, a hierarchy of preferences is included: (1) international standards, as implemented in member states; (2) other EC national standards; and (3) other standards. (Revised art. 7, par. 5.)

[23] *O.J.* No. C 230 (Aug. 28, 1987). Previous EC legislation: directive 71/305 of July 26, 1971, *O.J.* No. L 185/5; amended by 78/669 of Aug. 2, 1978, published *O.J.* L 225/41 42, (Aug. 16, 1978).

[24] Directive COM 88/354 is a revised version of directive COM (86) 679, which was proposed in 1987 as a measure to increase the openness of public procurement related to public works by way of amendments to the 1971 "works" directive.

[25] According to the EC Commission, a higher threshold had become necessary to reflect economic realities. The cost of construction works has increased substantially since the 1971 directive was issued, and major foreign contractors are reportedly only interested in work in other member states if the contract is big enough to make the

[25]—*Continued*
logistics of the operation economic. Commission of the European Communities, "Guide to the Community Rules on Open Government Procurement," *O.J.* No. C 358 (Dec. 31, 1987) p. 43.

[26] See ch. 6 for a discussion of the EC's proposed standards on construction products.

[27] Covered contracts encompass not only construction as such but also, for example, design, financing, management (of works) and other services related to public works, e.g., promotion contracts, management contracts, and "concession" contracts. See "Explanatory Memorandum" to proposed directive (86) 679, p. 2.

[28] The "Explanatory Memorandum" for COM (86) 679 states that, "Work in progress in the Community on the framing of contract documents in the form of performance requirements instead of detailed specifications should lead to more variants and thereby bring the technically most advanced solutions into the competitive arena," p. 12.

[22 Authorities must (1) explain why they have rejected a contractor's bid or application if the contractor asks them to;[29] (2) make a report on each award decision and supply it to the Commission upon request; (3) publish a notice on the outcome of each award decision; and (4) supply the EC Commission with data on procurement levels, award procedures, etc., on a regular basis and within specified time periods.

The revised proposal allows member states to retain regional preferences until December 31, 1992.

Remedies

Lack of effective enforcement mechanisms has been blamed for perpetuating discriminatory practices in member-state public procurement.[30] At the EC level, EC Commission oversight is hampered by a dearth of reliable, up-to-date statistics and other information. Statistical reporting is required in the supplies and works directives, but member states have been slow to comply and EC oversight has been hindered by a lack of common definitions for terms such as "foreign" and "national" products. The EC Commission also lacks a rapid means for mediating disputes about procurement practices. Redress through the EC Court of Justice is possible and has succeeded in some cases; however, this process is perceived as cumbersome and unpredictable.[31]

Some member states have formal redress procedures in place at both the administrative and judicial levels; others do not.[32] Even where formal mechanisms exist, wronged suppliers have little assurance that the remedy will come in time to make a difference. Bid deadlines are generally short, and contracts let within a few weeks. Most member states do not "stop the clock" when reviewing complaints, nor do they require rewriting of tender documentation or reopening of contracts. Suspension of an award decision is virtually never granted in practice,[33] and suppliers generally are not awarded monetary damages.

The evident failure of the existing enforcement mechanisms has encouraged procedural discrimination in public procurement and fed the reluctance of firms to invoke formal complaint mechanisms. Believing that new rules in public procurement would only produce real results if effective EC Commission oversight were possible, the EC Commission proposed a separate directive on "remedies" as part of its 1992 program.[34] The proposed remedies directive would only apply to contracts covered by the supplies and works directives. The directive has been through a first reading by the European Parliament and the Council has recently adopted a common position.

The Council's Common Position on Remedies is reportedly broadly consistent with the two major objectives of the remedies directive: (1) to put in place effective national remedies mechanisms and (2) to enable the EC Commission to better safeguard the EC interest by preventing violatins of EC procurement law before they occur.[35] Specifically—

- The Council retained intact the amended proposal's requirement that each member state put in place effective administrative and judicial remedies for suppliers who believe they have been discriminated against. They must assure EC suppliers of the access to complaint procedures, whether administrative or judicial, and ensure that, if satisfaction is not achieved at this level, suppliers have access to judicial or quasi-judicial appeals mechanisms. The competent administrative or judicial body must be empowered to (a) take interim measures, including suspending contract award procedures; (b) order the removal of discriminatory technical, economic or financial clauses in the invitation to tender, the contract documents, or in any other such document; (c) set aside decisions taken unlawfully and award damages to the

[29] This obligation is not included in the original "supplies" directive, nor its subsequent amendment by 80/767 and 88/295.
[30] Commission of the European Communities, "Explanatory Memorandum" for the revised "Remedies" directive, COM (88) 733, Dec. 8, 1988, p. 6.
[31] In its "Explanatory Memorandum," the EC Commission explains that, "The current means at its disposal are unsuited to the specific nature of the infringements in the public contracts field. The procedure relating to the failure by a member state to fulfill an obligation (Article 169 EEC) is cumbersome and slow (on average, judgement is given two years after the Commission starts proceedings), nor does it lend itself easily to the correction of procedural irregularities as encountered in the public contracts sphere. Proceedings usually reach their conclusion when it is no longer possible to remedy the consequences of the infringement. Further, Article 169 proceedings are addressed to Member States only and generally do not provide a basis for the Commission to intervene directly with regard to an individual decision by an awarding body." pp. 10 to 11.
[32] Some member states (e.g., France, Greece, Italy, Portugal and Spain) do have a relatively structured system for administrative appeal, however. See "Explanatory Memorandum" to proposed directive (87) 134, p. 9.
[33] "Explanatory Memorandum" to proposed directive (87) 134, p. 9.
[34] Directive COM (87) 134; Revised COM (88) 733, intended to "Coordinate laws and regulations for awarding public supply and public work contracts," (hereinafter, the "*Remedies*" directive) was proposed July 1, 1987; Parliament gave its opinion in May 1988, a revised proposal was submitted by the EC Commission on Dec. 8, 1988. Work on the new directive is expected to be finalized in 1989.
[35] "Explanatory Memorandum" to proposed directive (87) 134, p. 10 and USITC phone interview with staff of the EC Commission, July 10, 1989.

injured supplier. The EC Commission's right to intervene in such procedures as amicus curiae was dropped by the Council however, in light of objections by 5 or 6 member states.

- The EC Commission had proposed a mechanism wherely the EC Commission itself could intervene in contract-award procedures in cases of clear and manifest infringement, actually "stopping the clock" for a 3-month period in an effort to allow the EC Commission and the procuring entity to work out changes that would be consistent with EC law. The Council did not accept this aspect of the proposal.

  In its stead, the Council proposed creation of a mechanism whereby the EC Commission would notify member states and awarding entities when it believes infringements of EC law are imminent, explain the alleged infringement, and ask for corrective action. The member state would then be required to formally respond to the EC Commission within 21 days. This response could involve either a detailed explanation of why it considers the procurement procedure to be consistent with EC law or a report explaining the corrective actions taken. The EC Commission would then review the member state's formal reply and decide whether to begin infringement procedures under article 169 of the treaty. The EC Commission could also ask the Court of Justice to intervene in an award procedure, for example, by suspending the contract award. This has been done once before by the Court of Justice.[36]

The Council's changes substantially weaken the EC Commission's original proposal, since, in the words of the EC Commission, the article 169 procedure is "cumbersome and unsuited to the rapid correction of failures by awarding authorities to fulfill obligations specifically imposed on them."[37] However, it represents substantial progress in achieving an EC-wide consensus regarding the importance of ensuring suppliers in all member states of their rights to be accorded fair, nondiscriminatory treatment in public procurement of supplies and works. The Parliament is now considering the Council's position, and final approval of the amended directive is expected by yearend 1989.

[36] In the La Spezia case, the EC Court of Justice suspended award of a contract in response to EC Commission concerns (Case 194/88R, Order of the President fo the Court, Sept. 27, 1988).
[37] "Explanatory Memorandum" for the revised "Remedies" directive, COM (88) 733, Dec. 8, 1988, pp. 10-11.)

Water, Energy, Transport, and Telecommunications

As part of the 1992 program, four sectors—water, energy, transport, and telecommunications—will, for the first time, become subject to formal EC-wide procurement rules. Since the four sectors account for nearly 25 percent of EC public procurement, introducing greater competition and wider opportunities for EC suppliers in these sectors is considered a key goal of the EC's 1992 program. Extension of the GATT Government Procurement Code to cover these sectors is also presently under consideration. The United States has expressed a particular interest in increased access to EC telecommunications and heavy-electrical-equipment markets.

Background

The water, energy, transport, and telecommunications sectors were specifically excluded from the supplies and works directives, and are commonly referred to as the "excluded sectors." The stated reason for this exclusion was that the sectors presented too varied a mix of public and private ownership and control, making it difficult to achieve a similar degree of coverage and obligation among EC member states.[38]

In the past, most EC member states consciously sought to reserve procurement for national firms because they considered these sectors vital to the functioning of their economies and important in terms of technological development or local employment. "National champion" supplier firms were often sheltered behind a wall of technical, procedural, and attitudinal barriers that made it virtually impossible for outside suppliers to gain a foothold. Procuring entities frequently worked closely with their traditional suppliers on major procurements, sometimes even codeveloping products such as switching equipment or transmission gear. The four sectors are also marked by massive state ownership and influence, and are often subject to government regulation.

Reflecting the highly expensive and complicated nature of goods and works

[38] The "supplies" directive, as amended in March 1988, does not apply to contracts awarded by carriers by land, air, sea, or inland waterway; to contracts that concern the production, transport, and distribution of drinking water; contracts awarded by authorities whose principal activity lies in the production and distribution of energy; contracts awarded by authorities whose principal activity is to offer telecommunications services. Similar exclusions are found in the "works" directive, as amended, although some central government controlled telecommunications entities are covered by the "works" directive. Upon passage of directive (88) 378, these entities will no longer be subject to the "works" directive.

purchased in these sectors, public purchasers have relied almost exclusively on small pools of "qualified" suppliers, using either formal invitations to tender or direct negotiations with one or several firms. Since tendering is a costly business—for some sophisticated procurements in these sectors, the bid cost might account for as much as 10 percent of the final contract—there is an interest for both suppliers and purchasers to avoid an excessive number of failed bids. Further, the direct costs of evaluating complex bids are significant. Because entities in these sectors are responsible for providing essential services to the public and industry—drinking water, electricity, and phone service, for example—they frequently place heavy emphasis on quality, reliability, and after-sales service when evaluating potential suppliers. The need for products and services to fit into an existing, highly specialized network also means that compliance with standards and specifications is essential and can pose a problem for new suppliers.

The EC's proposed changes

Two directives on procurement in the excluded sectors were put forward by the EC Commission in October 1988: (88) 377; the EC Commission's proposal for a Council directive on the procurement procedures of entities providing water, energy, and transport services; and (88) 378, the EC Commission's proposal for a Council directive for entities operating in the telecommunications sector.

The directives attempt to introduce a degree of openness and competition into the procurement process in the heretofore "excluded sectors" by providing for minimum procedural guarantees of nondiscrimination and transparency. The directives are essentially divided into three parts: (1) coverage, (2) procedures, and (3) treatment of non-EC-origin bids.[39]

Coverage

a. Basis for Decisions on Field of Application

The directives include a functional definition of the types of entities that are covered on the basis of their relationship to the government, their powers, and their activities. The use of a functional definition reflects the EC Commission's desire to develop a concept that addresses the procurement problem in terms that permit situations that are in substance the same to be treated equally, regardless of differences in the legal or ownership status of the entities in question.[40] As drafted, major oil companies, such as Exxon and Shell, would be covered by the rules.

The proposed functional definition is based on the EC Commission's identification of underlying conditions that it believes lead entities in these sectors to pursue procurement policies that are uneconomical in the sense that they do not ensure that the best offer from any supplier or contractor in the EC is systematically preferred. Public administrations, public undertakings,[41] and private entities are covered by the rules[42] if two essential conditions are present:

(1) barriers to entry, often associated with reliance upon a technical network or provision of exclusive rights to exploit a geographic territory; and

(2) substantial government influence, achieved, for example, by government's power to grant operating approval or issue licenses or regulate rights to use a technical network or geographic territory.[43]

Indicative lists of covered entities are included in annexes to the directives. Member states are, however, bound by the functional definition.[44]

Entities presently specifically covered by the directive's provisions include those in the following sectors:[45]

Telecommunications
Drinking water[46]
Electricity, gas, or heat production, transport, and distribution

[39] Generally speaking, the directive on telecommunications incorporates all of the principles contained in the directive on water, energy, and transport by means of references to the relevant articles in that directive. Only explicit differences between the two are treated in detail in the directive on telecommunications. For the purposes of the summary that follows, the same approach is taken.

[40] Furthermore, such a definition of coverage is more precise than entity lists alone, since the legal form of covered entities can change and many of the entities in these sectors operate on the basis of concessions granted by the government under particular laws, which may turn over to different operators periodically. "Explanatory Memorandum" to proposed directive (88) 377, par. 7.

[41] Public undertakings are defined as those that are subject to the EC's directive on financial transparency, No. 80/723 of June 25, 1980.

[42] "Explanatory Memorandum" to proposed directive (88) 377, par. 58.

[43] Ibid., pars. 7 to 15.

[44] USITC staff meeting with Commission of the European Communities, Feb. 27, 1989. There are several exceptions to the functional definitions. The new legislation will not apply to areas in which liberalization is currently taking place or that are already deregulated. For this reason the legislation will not apply to road transport, shipping, and airlines. Entities that are otherwise covered are not required to follow the directives for certain types of purchases. Both directives include a general exemption for purchases intended for resale or hire in a competitive market. In the telecommunications field, the new rules will apply only to procurement for reserved services and not to procurement exclusively for use in connection with competitive services. In addition, the directives permit member states to seek exemption for contracts related to activities outside the scope of the directive.

[45] "Explanatory Memorandum" to proposed directive (88) 378, pars. 22, 23, 26, 24, 34, 62, 41, 42, 43, 37, and 48, respectively.

[46] "Explanatory Memorandum" to proposed directive (88) 377, pars. 22 to 23. Some water entities were already covered by previous EC directives on "supplies" and "works." However, changes in these directives, as

Oil exploration and production
Natural gas (all aspects)
Coal mining
Rail transport
Regional and local public transport (except public bus services operating under specified conditions)
Ports
Airports

Specifically not covered are purchases of fuels for use in the production of energy[47] and entities in the following sectors:

Airlines[48]
Transportation, refining, and distribution of petroleum products[49]
Sea and waterway transport services
Private coach services and road haulage firms
Maritime shipping

However, some of the entities and purchases presently not covered may be subjected to EC-wide rules at a later date.

b. Thresholds

Both directives apply to "supplies" and "works" contracts with a value in excess of 200,000 and 5 million ECU respectively. The directives also pertain to "concession" and management contracts,[50] which are common in the energy and water sectors in some member states. According to the EC Commission, the threshold of 200,000 ECU for "supplies" contracts is enough to purchase 7 km of large-capacity optical fiber cable, two standard buses, a 275 KV circuit breaker, a reserve feed-water pump, or a small crane. The 5 million ECU threshold for "works" is enough to upgrade 10 km of railway track, to build 2 km of TGV (Train de Grand Vitesse) on flat land, or to carry out dredging and repairs in an important port.[51]

Procedures

As noted previously, one of the major 1992-related changes in the public procurement area is the introduction of formal procedures that must be followed by entities in the "excluded sectors." However, since such entities frequently rely upon the exploitation of a technical infrastructure that can be complex and highly specialized, the obligations to be imposed are not as rigid as those applied to the essentially administrative bureaucracies covered by the "supplies" and "works" directives.[52] Specifically, entities are given greater flexibility in the choice of procedures and substantial latitude in implementing the specific procedural requirements set forth in the directives. The procedures themselves are also less rigorous.

The directives do not prescribe the circumstances in which a particular procedure may be employed. Open, restricted, or negotiated procedures may be used provided that there is a prior call to competition in one form or another.[53] The call for competition itself may take the form of a tender notice, a periodic notice, or an invitation to participate sent to candidates who have qualified.

The criteria for qualification and selection are not established in the directives themselves. Each entity is free to establish its own provided that all criteria used are objective, nondiscriminatory, and do not require the unnecessary repetition of tests or other proofs.[54] Two types of qualification systems are recognized: (1) those conducted on a permanent, regular basis and, (2) those that operate on an ad hoc basis in connection with specific investment projects.

[46]—*Continued*
well as passage of the directive on water, energy, and transport, reportedly mean that each entity in the water sector will be covered by only one set of rules. If drinking water is combined with other cycles, like purification and irrigation, then all aspects of that particular water entity's work will be covered by the directive on the excluded sectors. If, however, these cycles (irrigation and purification, etc.) are not linked to drinking water, the other directives ("supplies" and "works") will apply. In the case of concession contracts, the concessionaire would be a covered entity for the purposes of EC procurement rules unless the concession contract were itself let under competitive procedures.

[47] Purchases of primary fuels, such as coal, are to be addressed in the context of the EC's efforts to complete the internal market for energy. In relation to purchases of electricity, which are at present obstructed by obstacles to cross frontier operations, the EC Commission stated its intention to propose initiatives before June 30, 1989, and to remove these obstacles by 1992. "Explanatory Memorandum" to proposed directive (88) 377, par. 61. The EC Commission's most recent progress report, confirms its intention to "table specific proposals, on the one hand, to facilitate transfers of electricity and gas and, on the other hand, to increase price transparency for these two forms of energy for major industrial users." See, Commission of the European Communities, *Fourth Progress Report of the Commission to the Council and the European Parliament concerning the implementation of the Commission's white paper on the Completion of the Internal Market,* COM (89) 650 (Brussels: June 30, 1989), par. 18.

[48] In its "Explanatory Memorandum" to the directive on water, energy, and transport, the EC Commission states that airlines are excluded from the directive's scope for the time being but studies will continue and the situation will be kept under review. "Explanatory Memorandum" to proposed directive (88) 377, pars. 39 to 41.

[49] With respect to the transformation, transport, and distribution of petroleum products, the EC Commission states that, "the need for including these entities is far from being established," however, it stated its intention to keep the situation "under review." Ibid., pars. 42 to 43.

[50] "Explanatory Memorandum" to proposed directive (88) 377, par. 52.

[51] Commission of European Communities, "Public Procurement Procedures for Water, Energy, Transport, and Telecommunications Services," *Information* (June 22, 1988) p. 1.

[52] "Explanatory Memorandum" to proposed directive (88) 377, pars. 16 and 79 to 80.

[53] "Explanatory Memorandum" to proposed directive (88) 377, par. 18 and art. 12 of (88) 377.

[54] Proposed directive (88) 376 par. 427

The counterpoint to this flexibility is the transparency of the particular system that each entity applies. Not only must there be a prior call for competition unless one of the specific exemptions applies,[55] but at the same time the criteria for qualification, selection and award used by the entity must be made known in advance. Rules for qualification must be laid down in writing and they must be sent to anyone who has expressed interest.[56] In addition, all entities are required to publish periodic information notices on their planned procurement.[57]

Time limits for all phases of the award process are included in the directives.[58] The result of an award procedure must be made available to interested parties.[59] Debriefings for unsuccessful bidders are also provided for in the directive.

As in the case of "supplies" and "works," the directives on excluded sectors require entities, where practicable, to employ European standards in tender documentation. In the excluded sectors, relevant European standards and common specifications are often absent. Accordingly, the EC Commission decided that complementary measures were needed. One of these is the requirement that, unless there are sound reasons for not doing so, technical standards and specifications should be formulated in terms of functional requirements rather than particular techniques.[60] (Performance-based standards give suppliers greater flexibility in their choice of technical solutions. Standards based on particular production methods, although providing a high degree of certainty, tend to favor particular suppliers.)

Contracting entities are also obliged to make available to interested suppliers those technical specifications that are used regularly or that will be used for planned procurement, that is, their "specifications profiles." Such a provision ensures that, prior to the launching of a given contract, interested suppliers and contractors can assess their possibility of making competitive offers.[61]

Treatment of non-EC-origin bids

The proposals contain provisions designed to limit the benefits of liberalized procurement in these sectors to EC suppliers. Specifically, the proposals provide that the contracting entities may exclude offers in which less than half of the value of the goods or services[62] to be provided is of EC origin.[63] Furthermore, for the purpose of comparing prices, EC producers receive a mandatory 3-percent price preference.[64] In the words of the EC Commission, "the Community is running a serious risk of unilaterally making its domestic market more accessible to third-country firms if the directives on the excluded sectors fail to take proper account of the external dimension."[65]

The EC Commission continues—

> In these circumstances, the adoption of Community legislation opening procurement in the excluded sectors needs to be accompanied by measures designed to achieve the following general objectives. First, provisions are needed to defend the Community's commercial interests and defend its negotiating position by making no unilateral concession, but on the contrary, creating a positive incentive for third countries to give guarantees of equal access to similar markets. Second, Community producers should, where necessary, be given the necessary time for industrial adaptation required to meet the objectives of 1992 and the day when reciprocal access is finally agreed.[66]

The proposals provide that this requirement of favoring EC-origin goods and services can be adjusted through negotiations with third countries to secure equivalent treatment. The EC Commission states—[67]

> The equally important counterpart of these provisions . . . is a mechanism which will permit the Council, on a Commission proposal, to extend the benefit of the provisions to third country undertakings or

[55] "Explanatory Memorandum" to proposed directive (88) 377, par. 83.
[56] "Explanatory Memorandum" to proposed directive (88) 377, par. 99; proposed directive (88) 377, arts. 19 to 21.
[57] Proposed directive (88) 377, art. 14
[58] Time limits for receipt of information and bids from suppliers are set forth in art. 17 and those for provision of information by entities in art. 18 of proposed directive (88) 377 according to pars. 96 and 97 of the "Explanatory Memorandum."
[59] Communication from the EC Commission (88) 376, par. 429
[60] Ibid., par. 435.
[61] Ibid., par. 436.
[62] Art. 24, of directive (88) 378, par. 4 states—"For the purposes of this Article: (a) the value of products manufactured outside the Community shall include the value of all finished or semi-finished products imported, directly or indirectly, from third countries; (b) the value of services performed outside the Community shall include the value of all activities performed on the territory of third countries that contribute to the rendering of services covered by the contract."
[63] In its communication (88) 376, the EC Commission states, "In the absence of relevant international obligations, contracting entities are placed under no obligation to apply the provisions of the Directives to offers having their origin outside the Community. For this purpose, an offer is considered having its origin outside the Community when more than half its value represents goods or services produced or performed outside the Community or a combination thereof. Where a Community offer is equivalent to one from a third country firm or to one of third country origin, the Community offer should be preferred." See also par. 109 of its "Explanatory Memorandum" to (88) 377.
[64] The EC Commission states that, "a difference of up to 3 percent in favor of a non Community offer shall be disregarded." "Explanatory Memorandum" to directive (88) 377, par. 113.
[65] Explanatory Memorandum to proposed directive (88) 377, par. 104.
[66] Ibid., par. 107.
[67] Ibid., par. 110.

undertakings offering goods or services of third country origin. This mechanism makes it clear that the Community is not simply seeking to protect its own market, but is in a position to implement agreements with third countries on equal market access, whether reached through multilateral or bilateral negotiations.

When asked in field interviews whether the extension of benefits to third countries would be done on basis of sector-specific reciprocity or on a broader calculation of an overall balance of benefits, an EC Commission official replied:[68]

> The directive provides a mechanism whereby the Council can extend the benefits of the directive to third countries. There does not necessarily have to be a formal agreement. The Council may act, not necessarily only if reciprocity is present and not necessarily only if agreement is reached in the GATT Government Procurement Code. The mechanism is as broad as you like.

However, it is expected that the forum for such negotiations will be the renegotiation of the GATT Government Procurement Code now taking place under the auspices of the Uruguay Round and will involve reciprocal concessions.[69]

Telecommunications

The telecommunications industry in the EC reflects the relationship between the telecommunications services and their suppliers. The relationship is one of near monopsony in procurement, counterbalanced by an oligopolistic supply industry. There are essentially 12 major purchasers, or Post, Telegraph and Telephone Administrations (PTTs) in the EC, and 8 major EC producers. The sector is also highly regulated by member state governments, both in terms of services offered and rates.

Standards are a key issue in the telecommunications field.[70] According to the EC Commission, the choice of a technical solution is a crucial decision that always benefits a particular supplier.[71] It costs about $150 million to $200 million to adapt switching equipment that sells at $8 million to $9 million per unit, and sales must be high enough to cover this fixed cost of product adaptation, according to AT&T.[72]

In the face of strong pressures to reserve national markets in the member states for domestic firms and traditional suppliers, the EC Commission has moved towards a position of advocating increased EC-wide competition in public sector markets.[73] The EC Commission's intention to open up member-state markets for telecommunications equipment dates back at least to 1976.[74] Despite numerous EC policy statements since that time, progress in opening up national markets in the EC has been minimal. Between 1984 and 1988, the German Deutsche Bundespost awarded 99.5 percent of contracts to German firms; in France, the United Kingdom, the Netherlands, and Portugal, 100 percent of telecommunications contracts went to national suppliers.[75]

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[68] USITC staff meetings in Brussels with officials of the Commission of the European Communities, Feb. 27, 1989.

[69] The general agreement specifically exempts government purchasing from GATT rules. The Government Procurement Code is a limited agreement negotiated under GATT auspices during the Tokyo Round. The code creates rights and obligations that go beyond the general agreement. The water, energy, transport, and telecommunications sectors are not covered by the code, however. U.S. suppliers thus have no legal right to insist on nondiscriminatory treatment by EC public purchasers in these sectors. Extension of the code to such sectors is presently under discussion in the Uruguay Round. See chs. 14 and 15 for a discussion of the Government Procurement Code and proposals for its expansion in Uruguay Round. See ch. 13 for a discussion of the concept of reciprocity.

[70] Standards harmonization is a key element of the EC's overall policy toward telecommunications and its effort to complete the internal market by 1992. Although there is reason to believe that progress will be made in developing common EC standards in this sector, there is a danger that such standards could be biased against U.S. suppliers.

[70]—*Continued*
Indeed, the Communication from the EC Commission accompanying the proposed directives on excluded-sector procurement, (88) 376, par. 362, states, "insofar as European standards are established, competition will take place on European terms. The priority given to respect for European standards in the directives means that public contracting authorities would not be allowed to set aside a relevant European standard in favor of one imposed by a major producer in a third country, and that, in appropriate cases, certification of conformity of products to European standards would have to be obtained."

[71] Proposed directive (88) 376, par. 297.

[72] USITC staff interview with AT&T Germany GmbH, Mar. 22, 1989.

[73] EC Commission policies towards the telecommunications sector in general were spelled out in the 1987 Green Paper on Telecommunications. Among other things, the Green Paper called for a renewed effort to provide greater opportunities for EC firms in markets of other member states. In June 1988, the Telecommunications Council reaffirmed these goals and invited the EC Commission to submit proposals fully covering procurements of "supplies" and "works" by telecommunications entities. The proposed directive (88) 378 responds to this request.

[74] In December 1976, the Council invited the EC Commission to propose measures whereby supply contracts in this area would become subject to effective EC-wide competition. Specific measures were decided in 1984 when the Council adopted recommendation 84/550 according to which opportunities should be provided for undertakings established in other EC countries to tender for (a) all purchases of new telematic terminals and all conventional terminals for which there are common type approval specifications, and (b) at least 10 percent of the annual orders of switching and transmission apparatus as well as other than the above-mentioned terminal apparatus. "Explanatory Memorandum" of directive (88) 378, par. 3.

[75] "Explanatory Memorandum" to proposed directive (88) 378, pars. 3 and 4. Lack of common type-approval specifications has hindered implementation of this commitment, however.

The proposed directive on telecommunications, (88) 378, is substantially the same as that on water, energy, and transport in terms of the basis for coverage, procedural obligations, and treatment of non-EC origin bids. The main differences, and other notable points, are discussed below.

Coverage

In addition to "supplies" and "works," the directive applies to contracts for software services, the value of which exceeds 200,000 ECU. The directive's provisions are slated to apply to all network-related software services contracts from January 1, 1990, onwards. The directive also provides for the progressive liberalization of purchases of network and customer-premises equipment,[76] continuing a policy begun in 1984.[77] Open tendering will be extended to 60 percent of covered contracts by the end of 1989 as part of a graduated program to achieve fully open tendering by 1992.[78]

Procedures

The directive contains special provisions regarding the handling of software services contracts. A negotiated procedure without prior call for tenders may be used for such contracts. Like the directive on water, energy, and transport, the directive on telecommunications requires public purchasers to use EC standards in tender documentation. However, the directive's definitions of European standards and technical specifications are slightly different.[79]

Parliament has issued its opinion on both proposals, which are now being examined by the Council. Parliament's proposed amendments to the two directives are reportedly minor. Parliament proposed (1) reorganization of the proposals, notably by rearranging those articles dealing with entity coverage and by combining the two proposals—that on water, energy, and transport and that on telecommunications—into one and (2) changing the language on works contracts to make it more in line with the amended "works" directive. These changes should affect primarily concession contracts in the water sector.

Parliament also added its preference that agreements to extend the benefits of the directive to third countries be made in the GATT. The Parliament confirmed the EC Commission's proposed thresholds (200,000 ECU for supplies and software; 5 million ECU for works), confirmed the field of application, and did not change the value-added rule for determining EC origin (i.e., 50 percent). The EC Commission is reviewing the Parliament's suggested amendments and will submit a revised proposal this summer.

[76] "Explanatory Memorandum" to proposed directive (88) 378, par. 9.
[77] This 1984 recommendation is discussed above.
[78] "Explanatory Memorandum" to proposed directive (88) 378, pars. 97 to 100.
[79] The definition of European standards was changed to reflect the role of the European Telecommunications Standards Institute (ETSI) in standardsmaking for such equipment. In addition, technical specifications need not necessarily correspond to European standards, as this might prejudice the application on the initial stage of the mutual recognition of type approval for telecommunications terminal equipment. "Explanatory Memorandum" to proposed directive (88) 378, par. 39.

Possible Effects

Most of the EC's government procurement directives are viewed as positive changes by procurement experts in the United States. Indeed, some directives are substantively similar to previous U.S. proposals for change.[80] The key question will be on how these directives are implemented at the member-state level and whether the EC's proposed enforcement mechanisms will prove adequate to the task.

Movement towards more open procurement in the sectors of water, energy, transport, and telecommunications is also viewed as a positive step by U.S. business. However, many U.S. suppliers fear that sales to EC public purchasers could be threatened by overzealous application of the 50-percent value-added rule contained in the excluded-sector directives. The words of one U.S. business representative were fairly typical—

> The local content standard—I just want to explain, very briefly, how that works. The Europeans generally say that it's only a 3-percent price differential anyway. If you can underbid by more than 3 percent, then the European procuring agency or company is not required to give EC preference. . . However, if you're not 50 percent EC content, they're not required to consider your bid at all. I mean, that's the sort of overriding concern, from our point of view.[81]

On the one hand, the EC's new rules could encourage more open procurement by entities at all levels in the member states. In the case of the "excluded sectors," all suppliers offering products that meet the EC's definition of an EC product (50 percent EC value added) should be eligible to compete for contracts with covered entities, should be assured of nondiscrimination and predictability in procurement procedures, and should qualify for an optional 3-percent price preference.[82] U.S. suppliers will also have the

[80] USITC staff interview with officials at the Office of the United States Trade Representative and the U.S. Department of Commerce.
[81] Testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers, Apr. 11, 1989, transcript, p. 101.
[82] Suppliers of products that are less than 50 percent EC value added may still be eligible for contracts, at the discretion of the purchasing entities.

right to compete on an equal footing with EC suppliers for most central government purchases of "supplies" because much of this procurement is covered by the GATT Government Procurement Code.[83] To the extent that the revisions result in more effective procedures and open procurement, they will improve the EC's ability to fulfill its GATT code commitment to provide U.S. suppliers with nondiscriminatory treatment and fair opportunities to compete for goods contracts let by central-government ministries in the EC member states.

U.S. firms may also benefit from the directives' requirements for public announcement of tenders, projected annual purchases, and winning bidders, since such information could help them pursue primary and subcontract opportunities in the EC. (The supplies, works, and excluded-sector directives all contain such requirements.) It appears that U.S. subsidiaries in Europe and importers could be eligible to seek redress against procedural irregularities in "supplies" and "works" contracts under the revised "remedies" directive.

The "excluded sectors" and services are not covered by the GATT, however. Therefore, the EC is not obliged to ensure U.S. suppliers access to such contracts, nor to follow the GATT Government Procurement Code's requirements for transparency and nondiscrimination in procurement practices. Continued discrimination against U.S. suppliers in these sectors would not be grounds for formal dispute settlement in the GATT or the Government Procurement Code. Indeed, as noted above, the EC has essentially stated that it intends to use the possibility of discrimination against non-EC suppliers as leverage to obtain reciprocal market opportunities for EC firms.

The directives may also affect the competitiveness of EC suppliers relative to those in the United States and elsewhere. In several key sectors, notably computers, telecommunications, and heavy electrical equipment, heightened competition among EC "national champions" and gains from economies of scale could lead to the eventual strengthening of EC competitors in world markets. In other sectors, restructuring will not be without tradeoffs, and the EC has signalled its intention of allaying adverse effects on employment and regional development.[84]

[83] GATT Government Procurement Code signatories will automatically qualify for the broadened coverage of the revised "supplies" directive (i.e., by virtue of the narrower definitions of exclusions).

[84] The EC Commission will apparently put together a package to succeed the present regional preference schemes that would involve: (1) the progressive elimination of regional government procurement preferences; (2) development of certain nondiscriminatory contract conditions for addressing unemployment; (3) support for the participation of small-and medium-sized enterprises and firms from depressed regions in public procurement throughout the EC. An official said that the EC Commission is thinking of providing aid and technical expertise to smaller firms so that they can make bids on contracts in other member states and undertake the adaptations to their products required to sell in other EC markets. The EC Commission may also offer operating aid to those regions in decline. USITC staff meetings in Brussels with officials of the Commission of the European Communities, Feb. 27, 1989.

[85] Mike Merin, Office of Multilateral Affairs, U.S. Department of Commerce, "Goverment Procurement code Nogotiations Near Critical Phase," *Uruguay Round Insider*, November 1988.

U.S. Exports to the EC

Opening up EC public sector markets to non-EC suppliers will generally provide additional export opportunities for U.S. firms. The supplies directive should be trade liberalizing for U.S. producers of construction and mining machinery, medical goods (despite the presence of several large national EC suppliers, U.S. exports are already very competitive in the EC public sector), and computers (to date, U.S. companies have been very successful in exporting to the larger, private EC market for these products). In addition, the supplies directive should provide limited export opportunities for U.S. producers of motor vehicles and motor-vehicle parts (sales of which are often linked).

U.S. suppliers of services will not be directly affected by the EC's proposed procurement directives. In the case of accounting services, U.S. firms already dominate the EC market through local partnerships staffed primarily by EC nationals. U.S. contractors of architectural, engineering, and construction (AEC) services, (which already hold competitive advantages relative to EC firms with respect to design, construction management, and sophisticated turnkey projects), believe that, given an opportunity, they would substantially increase their share of the EC public sector over several years. As noted previously, however, the EC is under no obligation to extend the benefits of the directives on "works" and the excluded sectors to U.S. firms.

The extension of the GATT Government Procurement Code to services contracts and the "excluded sectors" is presently under consideration. The United States may have an opportunity to secure commitments from the EC on open access for U.S. suppliers in that forum. Indeed, the likelihood of extending the code to such contracts is improved with passage of the EC's proposed directives. The lack of EC Commission authority in this regard has made coverage of excluded-sector contracts in the original code and its subsequent revision effectively impossible.[85] The value-added rule is likely to be a key aspect of such discussions. However, the EC may seek increased access in the United States in return for changes in its proposed policy. Some industries might prefer to

keep intact current U.S. restrictions on foreign participation in federal, state, and local procurement.

Agreement on extension of the GATT to the excluded sectors could improve prospects for U.S. suppliers in the EC market. This is particularly true for data processing services (U.S. firms have a comparative advantage with respect to software technology), optic fiber and related equipment (U.S. exports could rise slightly because of patent and licensing arrangements), and radio and television communications equipment. U.S. exports of network-related telecommunications equipment also stand to gain but could continue to encounter barriers if EC product standards are discriminatory.

Further, exports of these items could be disadvantaged by the EC's proposed 50-percent value-added rule. According to the EC Committee of the American Chamber of Commerce in Belgium, "Business is concerned about provisions permitting rejection of 'economically advantageous' and lowest price bids if the products involved do not meet a 50 percent EC origin requirement."[86] U.S. suppliers fear discrimination against non-EC suppliers in these sectors, a loss of existing sales to EC public purchasers, and unwanted changes in sourcing patterns. Indeed, U.S. Representative Sam Gejdenson recently reported that,

> These [local-content] requirements are already reducing U.S. exports and forcing U.S. companies to invest in Europe. An electronics expert informed the Subcommittees that U.S. electronics firms have already received letters from European buyers telling them to open up costly plants in Europe or lose the contracts [with government purchasers] that they have held for years.[87]

The wide latitude given to EC purchasers in interpreting the rule has fueled uncertainty by U.S. suppliers. The method of how domestic content will be calculated has yet to be clearly defined and is a major source of concern for U.S. suppliers. In the case of telecommunications for example, a key issue will be how software is valued for the purpose of determining EC content. Moreover, there is a possibility that the EC-content level and price preference could be raised.[88] The potential problems faced by U.S. suppliers are typified in the following example.[89]

> Such rules may appear innocuous in isolation, but in *combination*, they can and do operate to create incentives for down-stream product manufacturers to buy European-, rather than non-EC origin, components. . . . A recent example will illustrate the problem. A Japanese printer manufacturer told its U.S. supplier that to avoid dumping duties on its printers assembled in Europe under the EC's "screwdriver assembly" regulation, it must "design out" U.S. semiconductors so that the boards going into its printers will count as EC-origin rather than Japanese origin. By replacing U.S. chips with European chips, the European content of the boards can be raised to 45 percent, and the Japanese manufacturer thereby increases its total non-Japanese content in the finished product to over 40 percent and avoids the "screwdriver" dumping duty. Note that this is accomplished without actually reducing the number of Japanese parts — Japanese content levels are maintained as U.S. chips are replaced with European chips. The loser in this equation, obviously, is the U.S. supplier.

The directives' provisions on standards could also have an impact on U.S. firms. According to the National Association of Manufacturers[90]—

> The directives require that specifications in a contract must be in conformity with existing European standards, except that an indefinite waiver is provided when the contracting authority can show incompatibility with existing national systems and equipment or "disproportionate cost" in effecting a changeover to EC standards in the contract. The [EC] Commission staff's present expectation is for any such protection to diminish rapidly, to disappear in three to five years.

Given the importance of standards and technical specifications to such procurements, EC policy in this regard will have a crucial impact on the future openness of the EC market to U.S. firms.

Diversion of Trade to the U.S. Market

In most product areas, the EC's government procurement directives are not expected to significantly alter current trade patterns and thus create the potential for the diversion of trade to the U.S. market. Since public entities in the EC currently purchase less than 2 percent of their requirements from nonnational suppliers, it is presumed that third-country suppliers would not lose substantially, even if the EC procurement

[86] *Business Guide to EC Initiatives* (Brussels, Autumn 1988) p. 64.
[87] Opening statement of Representative Sam Gejdenson, Chairman, Subcommittee on International Economic Policy and Trade, House Committee on Foreign Affairs, May 10, 1989, p. 2.
[88] According to the Apr. 26, 1989, edition of the *European Report*, the European Parliament's Committee on Economic, Monetary, and Industrial Affairs was seeking to raise the proposed EC-value-added requirement contained in the two "excluded sector" directives from 50 percent to 60 percent and to increase the price preference for EC offers to 10 percent, rather than the 3 percent originally proposed by the EC Commission.
[89] Testimony before the House Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade by Michael Maibach, Director, Government Affairs, Intel Corp., Mar. 23, 1989.
[90] National Association of Manufacturers, *EC 92 and U.S. Industry*, February 1989, p. 22.

environment deteriorated. Furthermore, industry sources indicate that U.S. consumers often require different designs and technical specifications and many products also require timely after-sales service. Both factors usually imply a U.S. presence.

However, there is some evidence that should Japanese suppliers of optic fiber and related equipment, telephone and telegraph equipment, and medical equipment to the EC be significantly harmed as a result of these directives, a portion of Japanese exports of these products could be diverted to the United States. U.S. industry sources indicate that such third-country suppliers have more to lose by the EC's proposed 50-percent content rule.

U.S. Investment and Operating Conditions in the EC

The directives on the excluded sectors clearly create an incentive for U.S. firms to increase the percentage of production accounted for by European parts, labor, and services.[91] In addition to imposing a method of determining who qualifies for the directives' benefits on the basis of EC content, the EC Commission has opened the door for procuring entities to exert pressure on suppliers to increase their European content. Since there is no restriction on the types of information entities may seek in order to implement the rule, entities may seek access to very detailed proprietary information. Moreover, interviews with procuring officials in the member states suggest that the rule is being interpreted as a general "Buy EC" requirement. Many U.S. firms, meanwhile, seem to be operating on that assumption. In the words of one business representative—[92]

> . . .[T]here's sort of good news and bad news. The good news is that the European Community is now opening up a sector which has never before been. They've always refused to open that sector to the GATT, or even to internal market discipline. And that is the good news—that it is going to be open. And they have said specifically, and repeatedly that this is subject, also, to multilateral negotiation on a reciprocity basis. But unfortunately, they've also added a local content standard, which sets a precedent in a different direction that we're not too pleased with. . . it's difficult at this time to determine whether . . . . investment is going to Europe basically to follow economic opportunity, or because of fear of the application of the local content standard.

The value-added rule in these two directives could make increases in U.S. investment activity, licensing arrangements, and joint ventures necessary to increase sales in the EC for U.S.-owned firms producing heavy electrical equipment, water measuring and control equipment, chemicals for water treatment, valves, pumps, and compressors, and telecommunications equipment.[93] Many U.S. suppliers appear to be responding by pursuing direct investments in the EC as well as joint ventures and licensing arrangements with EC companies. Indeed, major merger and investment activity is already under way.[94]

In response to the supplies directive, U.S. investment in the EC should increase for firms producing computers (the EC market is expanding rapidly and becoming increasingly competitive) and medical equipment. Further, there could also be a small rise in investment in the EC by U.S.-owned firms producing motor vehicles and motor-vehicle parts.

The investment and operating implications of the EC's directives are relatively minor for U.S. producers of construction equipment (the private market is much larger), architectural, engineering, and construction services providers

[91] "We see it [aggressive pursuit of European investment] being done perhaps most agressively in the telecommunications and information technology sectors, where American companies are highly competitive, and where, under the existing proposals, there are clear advantages to having EC partners and EC based production." Testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers, Apr. 11, 1989, transcript, p. 91.

[92] Testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers, Apr. 11, 1989, transcript, p. 101.

[93] U.S. Representative Sam Gejdenson, Chairman, Subcommittee on International Economic Policy and Trade, House Committee on Foreign Affairs, held hearings on Mar. 23, 1989, on the proposed EC changes to government procurement regulations regarding local content and rule-of-origin restrictions. Although all of the witnesses expressed concern, a detailed presentation was made by Michael Maibach of Intel Corp. Mr. Maibach noted that, "because of the EC new rule of origin for integrated circuits (ICs) under which the origin of the semiconductor is to be determined by the location of the wafer fabrication, to obtain EC origin, a semiconductor will now have to contain a die (the silicon "chip" itself) fabricated in the EC."

[94] "There's a factor here at play that no one has mentioned, and that has been underestimated even by the European Commission itself. Let's look at some of the deals that have been cited publicly. There's the AT&T deal with Italtel. There's AT&T in Spain with Telefonica. There was the fighting over the number two French telecommunications producers. There's General Electric's involvement in this GEC Plessey proposed merger. And there's the agreement between ITT and Alcatel. What we typically find in this situation is that the prospects of EC 92 are leading European companies not just to seek alliances with other European companies—that's the Commission model. But it's just as logical for them to seek alliances with non EC companies. And I think you'll find that occurring not just in telecommunications, but in industry after industry." Testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers, Apr. 11, 1989, transcript, p. 103.

(U.S. contractors typically work in a member state for the duration of a project only), and accounting services firms (the "Big 8" U.S. accounting firms already dominate the EC market). Finally, the directive that addresses energy services will not impact U.S. investment in the EC for U.S. coal suppliers (EC governments will continue to play a major role in their coal industries) and producers of boilers (excess capacity is already prevalent in the EC market).

Industry Analysis

On the basis of available information on the product composition of EC public procurement, industry analysts were assigned to determine the impact of the EC's proposed directives on 20 U.S. industries. These industries were grouped under categories corresponding with the directive most immediately affecting their sales to EC public purchasers. However, some sectors, such as computers, are affected by more than one directive, e.g., supplies and telecommunications.

Architecture, Engineering, and Construction Services

Possible Effects

U.S. exports to the EC

To date, U.S. firms have had limited success in the EC public sector market for AEC services. On the basis of their experience in private sector markets, however, U.S. contractors believe they would be competitive in project bids if provided an opportunity to compete on an equal footing with EC suppliers. In 1988, U.S. contractors won an estimated $5.1 billion worth of project work in the EC private market, which represented 30 percent of the EC private sector market for AEC services. Elsewhere, U.S. contractors won $2.6 billion in contract work in Latin America in 1988, $5.1 billion in the Mideast, and $4.5 billion in Asia, representing a 36-,38-, and 23-percent market share, respectively.

U.S. contractors consider the EC public works market to be potentially lucrative because of several upcoming large and expensive intra-EC projects, such as the Eurotunnel and the proposed European high-speed rail link. Up to now, U.S. contractors have not been allowed to bid on EC public works projects because EC public purchasers have favored "national champion" firms. EC public works projects have normally been procured through negotiated tender with major European contractors such as Bouyges and Dumez (France), Philipp Holzmann (West Germany), and Davy (United Kingdom). U.S. industry officials allege that most of these major EC national champion firms receive financial subsidies and benefit from research and development collaboration with their governments. U.S. AEC firms are considered competitive with EC contractors, with respect to technical expertise. In certain areas, such as design, construction management, and sophisticated turnkey projects, the U.S. industry possesses a competitive advantage.[95]

U.S. industry officials believe that if the EC open-bidding conditions were enforced, U.S. contractors that export their services to the EC might garner a 25- to 30-percent share in the EC public works market over the next several years. The directives' requirements for prior announcement of procurement plans may also enhance U.S. firms' prospects. In addition, greater U.S. AEC contracts could also lead to increases in sales of U.S. construction equipment and supplies if a particular EC public project should require such materials.

Diversion of trade to the U.S. market

There is not likely to be significant diversion of AEC services trade to the United States as a result of the public works directive. Foreign contractors are already well represented in the U.S. market for AEC services; no further displacement of U.S. domestic service providers is anticipated.

U.S. investment and operating conditions in the EC

At the moment, U.S. contractors export their services, working in-country for the duration of the project only, and occasionally in a follow-up capacity if required. Whereas U.S. contractors do form joint-ventures abroad in order to work successfully in certain countries, and several major U.S. firms maintain representative offices throughout the EC, U.S. firms do not engage in direct project investment. If the directives on public procurement are adopted, however, it is plausible that U.S. contractors will seek more joint ventures with EC contractors in order to better access the EC public works market. To successfully bid on EC public works projects, however, U.S. industry sources emphasize that U.S. contractors will have to arrange competitively attractive financing packages in order to offset subsidies allegedly offered to the EC national champion firms by their governments.

U.S. Industry Response

Certain major U.S. AEC contractors will begin to seek to market their services to the EC public purchasers. Once a likely project is

[95] In p. 7 of his written testimony before the House Committee on Foreign Affairs on Apr. 13, 1989, Manuel Peralta, President of the American National Standards Institutes, states, "It is generally believed that most EC Member States, by favoring local suppliers, have produced public works which are less efficient and of poorer quality than their counterparts in other jurisdictions."

identified, the U.S. firms may approach the major EC contractors in an effort to form bidding partnerships.

Views of Interested Parties

No formal submissions were received.

Medical Goods

Possible Effects

U.S. exports to the EC

The "supplies" directive may be beneficial to U.S. producers of medical equipment and apparatus. The public sector market for medical goods is moderately important relative to the total EC market for such goods. In most EC countries, a government ministry or department is responsible for supervising and organizing health insurance in the country and for funding public health facilities, including hospitals. Actual purchases of medical equipment, though government funded, are usually handled in a decentralized manner at the local level. France is the only country with a somewhat more centralized purchasing process, which has tended in the past to favor French producers for major purchases of high-technology equipment. Nevertheless, U.S. products have been well regarded by French doctors and authorities and have historically sold very well in the French public and private markets for medical goods.

U.S. firms have also been very successful in selling medical instruments in other EC markets and sales of equipment have increased significantly over the past 2 years with the devaluation of the U.S. dollar. U.S. exports to the EC increased by 21 percent, from $1 billion in 1986 to $1.2 billion in 1987. Products made by subsidiaries of U.S. companies in the EC accounted for an additional $3 billion, according to estimates by U.S. industry officials. All together, products of U.S. companies and their EC subsidiaries may account for almost 25 percent of the EC market.

Because U.S. firms possess significantly higher market shares than do EC firms in third-country markets, industry experts believe the U.S. industry will maintain their market shares of EC markets notwithstanding the fact that large EC companies like Siemens and Phillips will also benefit from scale economies and other dynamic effects achieved with EC integration.

Diversion of trade to the U.S. market

Japan is extremely competitive with the United States in hightechnology imaging devices and other electromedical and surgical equipment where 60 percent of total trade in medical goods occurs. Japan should benefit just as much as the United States and other large EC manufacturers in the expanded market. It is thus unlikely then that a significant amount of Japanese trade will be diverted to the United States as a result of the directive.

Japan's major export markets, based on trade during 1987, consisted of the United States (about 45 percent), the EC (30 percent), and Canada (7 percent). In 1987, total U.S. imports amounted to $2.3 billion, or about 17 percent of apparent U.S. consumption. U.S. imports of Japanese medical equipment more than doubled, from $211 million in 1983 to $570 million, or 25 percent of total U.S. imports, in 1987. West Germany was the largest supplier of medical equipment imports to the United States in 1987, with $630 million, or 27 percent of total U.S. imports in 1987. The United Kingdom, the Netherlands, and France combined accounted for 16 percent of U.S. imports in 1987.

U.S. investment and operating conditions in the EC

The directive is likely to encourage future U.S. investment in EC business as EC-based manufacturers will be well positioned to take advantage of opportunities that open up in the EC market. A number of large U.S. firms, such as Hewlett Packard, Beckman Instruments, Varian, Litton, Travenol Instruments, General Electric, and Puritan, have established manufacturing subsidiaries in one or more EC countries to supply those markets, as well as third-country markets. Not only do these EC operations represent a substantial amount of U.S. direct investment in the EC market, but they also serve as important importers and distributors of U.S.-made medical equipment and parts. Industry officials believe that investment and merger activity should increase somewhat by EC and foreign-owned subsidiaries, including those of U.S.-based multinationals, as the EC approaches full integration. In August 1987, the U.S.-based General Electric Corp. (GE) completed a deal with France's state-owned Thomson S.A. in which GE obtained Thomson's medical-imaging business. In 1987, the Dutch manufacturer Phillips announced that it would merge its medical division with Picker International to form one of the largest medical equipment companies in the world.

If the directive, as expected, results in a true opening up of the government-controlled medical procurement market in the EC, it will be less important for U.S. companies to establish a manufacturing presence in their most important markets, such as France, West Germany, and the United Kingdom. Instead, U.S. companies can look at other factors, such as wages and utility costs, which may favor locations in Greece or Spain. Theoretically, as EC operations, companies there will have just as much an opportunity as French and West German

companies to secure contracts with French and West German procurement officials.

U.S. Industry Response

U.S. industry officials believe that EC integration overall should have a beneficial effect on both U.S. exports and investment in the EC. These officials are not overly concerned because not many medical goods are purchased on a contractual basis by a central-government authority, but rather they are usually purchased on a decentralized basis at the local-hospital end of each country's health service. Chief physicians are still the primary determinants of what equipment will be purchased.

Officials of U.S. firms with strong ties to the EC market are optimistic about the completion of EC integration since it will result in common technical standards that when met will permit greater production runs and lower costs. EC integration will also reduce a number of market barriers and border transactions within the EC that should streamline shipping costs. Because U.S. firms have had few difficulties selling to the EC government procurement market in the past, they expect to have few difficulties after 1992.

Views of Interested Parties

No formal submissions were received.

Computers

Possible Effects

U.S. exports to the EC

Currently, EC public sector markets for office machines reportedly are served for the most part by national companies. Although the directives on government procurement appear to liberalize the opportunities for outside suppliers, the actual effect will depend on the interpretation of the value-added rules and a determination of what constitutes an indigenous company.

The EC provides a large market for computers produced by U.S. firms in the United States and by their subsidiaries located in the EC. In 1988, U.S. exports of computers and related automatic data processing machines reached $21.8 billion, or a level about 64 percent larger than those in 1984. U.S. exports to the EC grew more rapidly than U.S. exports to the world during the period, increasing from $6.1 billion in 1984 to $10.7 billion in 1988, or by 76 percent. The United Kingdom ($2.9 billion) and West Germany ($2.2 billion) remained the largest markets in the EC, receiving about 48 percent of total U.S. exports to the EC. Canada and Japan were the two largest foreign markets outside the EC during the period, receiving $2.6 billion and $2.3 billion, respectively, in U.S. exports in 1988.

U.S. firms accounted for an estimated 46 percent of the EC market for computers and related automatic data processing machines in 1987, either through exports or local production, according to *Datamation*.[96] The EC market is about 50 percent as large as the U.S. market, which is estimated at $54 billion in 1988. The principal U.S. suppliers to the EC are IBM, Digital Equipment, Unisys, and Apple Computers. The principal EC suppliers are Siemens (West Germany), Nixdorf (West Germany), Phillips (The Netherlands), and Groupe Bull (France). Many EC suppliers are dependent on member-state financial support. IBM considers itself to be a European company given its substantial investment, manufacturing, and research and development presence there.

The open or merchant market for computers and related data processing machines is about two times as large as the public sector markets in the EC. U.S. firms dominate the open market for these machines, whereas the indigenous or local firms dominate the public sector markets. Opening up the respective public sector markets to EC-wide competition would be likely to provide additional marketing opportunities for U.S. firms but at the same time would be likely to cause large EC suppliers to rationalize their operations in order to meet the added competition from U.S. firms. Some U.S. firms have established large manufacturing facilities in the EC and are well positioned to serve the public sector markets if these firms are treated on an equal footing as indigenous suppliers. EC suppliers are dependent on member states' financial support. In addition, English is predominantly used in software applications, thus providing U.S. firms with an added advantage.

Diversion of trade to the U.S. market

It is unlikely that changes in EC public procurement policy would result in a diversion of trade in computers and related data processingmachines from the EC to the U.S. market. The principal third-country suppliers of computers to the EC are Japanese firms (Fujitsu, Nippon Electric, and Hitachi), and these firms are not expected to either lose or gain market share because of the greater openness of the public sector market. In fact, the major user industries (insurance, banking, and food processors) in the EC are also anticipating increased competition and are attempting to modernize their operations before 1992. This increase in demand is expected to provide significant additional merchant market opportunities for U.S. firms and also to provide certain market opportunities for Japanese firms. The service industries, such as banking, insurance, tourism, etc., are particularly sensitive to office-automation improvements. Thus the EC open market can be expected to expand

[96] *Datamation* (June 15, 1988), p. 15.

significantly unless the EC turns inward and erects stiff external barriers. Should this happen, then trade diversion from Far Eastern countries to the U.S. market could occur. However, since imports are believed to supply only a small part of EC public procurement, the scope of such diversion is expected to be small.

U.S. investment and operating conditions in the EC

U.S. investment in the EC in computers and related data processing machines exceeds $14 billion, and U.S. multinational firms, notably IBM, Unisys, and Apple Computers, dominate the open market in the EC. The EC market for computers is expanding rapidly because worldwide competition in end-product equipment and service industries has necessitated increased rationalization and modernization in the economies of the member states. Computers and informatics are increasingly recognized as a key element in improving production efficiencies and developing more competitive products. To many in the EC, it has become clear that the EC is falling behind the United States and Japan in the area of informatics, and accordingly, EC leaders have emphasized the need to establish EC-wide industries that can compete in world markets. Market fragmentation, duplicative standards, and restricted public procurement in member states have long been recognized as costly and inefficient. As the user industries modernize, U.S. computer firms can be expected to increase their investments in plants, equipment, and research in order to serve this expanding market. Furthermore, some industry sources are of the view that, faced with uncertain access to the EC, the most prudent approach might be to plan for in-country production rather than to serve the EC with exports.

U.S. Industry Response

The largest U.S. producer of digital computers, which has extensive investments in the EC, has indicated that the outcome of current GATT negotiations would have considerable effect on the application of these directives. The firm is closely watching 1992-related development and has indicated that it would choose to work directly with the office of the United States Trade Representative if problems arose over EC integration that affected the firm. Many firms in the industry, however, are just beginning to assess the potential impact of the 1992 directives.

Views of Interested Parties

No formal submissions were received.

Construction and Mining Equipment

Possible Effects

U.S. exports to the EC

U.S. exports of construction and mining equipment to the EC could increase because of the new public supply procurement procedures. Despite the presence of competition from several EC national champion firms—Fiat (Italy), Liebherr (West Germany), and JCB (United Kingdom)—at present, U.S. construction equipment is very competitive in the EC market. In 1988, U.S. exports of construction and mining equipment to the EC totaled $726 million, which accounted for 18 percent of total U.S. exports of construction and mining machinery. The United Kingdom ($261 million) was the largest EC market for U.S. exports of construction and mining equipment in 1988, and the second-largest market for U.S. exports overall. Canada ($702 million) was the largest U.S. export market in 1988.

U.S. construction-equipment manufacturers hold an estimated 28-percent share of the EC private sector market for construction and mining machinery. U.S. industry officials estimate that if open bidding procedures were enforced, U.S. equipment manufacturers would gain an additional 15- to 20-percent share of the EC public-supply market over the next 5 to 10 years. Furthermore, the directives on the excluded sectors could open up opportunities related to projects in public works and coal mining.

Diversion of trade to the U.S. market

There is not likely to be a significant diversion of trade to the United States as a result of the public-supply directive. Imports of construction and mining machinery already account for a significant share of U.S. consumption. Major third-country suppliers include Komatsu and Mitsubishi from Japan as well as the aforementioned European suppliers. Japanese firms are also, however, well established in EC private sector markets. However, given the already low level of imports by public purchasers in the EC, no further displacement of U.S. production is anticipated by diverted Japanese exports.

U.S. investment and operating conditions in the EC

U.S. investment decisions regarding the EC are unlikely to be dictated by future opportunities in the EC public-supply market. Major U.S. construction-equipment manufacturers indicate that, in general, they consider EC public procurement of construction machinery to be a low-volume, low-margin business. The U.S. construction and mining industry has invested over $1 billion in plant and capital in the EC over

a 30-year period; in addition, U.S. firms already benefit from substantial name recognition in the EC market.

The EC subsidiaries of major U.S. construction-equipment manufacturers both procure and produce parts for their equipment locally and source them from their worldwide network of manufacturing plants and dealerships. The public-supply directive will have some impact on the operating conditions of U.S. subsidiaries in the EC. The directive may make it easier for U.S. firms to move into the EC as direct agents and distributors of their machinery in order to market these products to EC public-procurement purchasers. At present, if U.S. construction machinery is procured by an EC member state, it is done through an EC dealer that buys the equipment outright and sells it as "European" in order to better compete against those contracts normally reserved for EC national-champion suppliers. The U.S. manufacturer supplies the EC dealer through its EC subsidiary or through direct export. The U.S. supplier also provides parts and follow-on support (which is generally reserved for the prime bid supplier) to the EC dealer. Much depends on how the public entities interpret the proposed EC value-added rule.

U.S. Industry Response

The U.S. industry would like to obtain further access to the EC public-supply market. Among the range of U.S. products available to the EC market, U.S. manufacturers believe that their smaller units would be most suitable for European working conditions; nevertheless, U.S. firms are not expected to take special actions to market these products in the EC market. U.S. industry sources indicate that sales of U.S. equipment to EC public purchasers will be much more likely if U.S. construction or engineering firms have won EC public-project bids. The U.S. equipment sales could then piggyback on the U.S. services contract.

Views of Interested Parties

No formal submissions were received.

Accounting Services

Possible Effects

U.S. exports to the EC

U.S. accounting firms are dominant in the EC member states but tend to operate through local partnerships rather than by exporting. For instance, Arthur Young's affiliate in the United Kingdom is considered a British firm. The "Big 8" U.S. accounting firms are also dominant in the EC member states. The "Big 8" are—

Arthur Andersen and Co.
Arthur Young and Co.
Coopers and Lybrand
Deloite, Haskins and Sells
Ernst and Whitney
Peat Marwick Main and Co.
Price Waterhouse and Co.
Touche Ross and Co.

Diversion of trade to the U.S. market

No diversion of trade to the U.S. market is anticipated.

U.S. investment and operating conditions in the EC

As mentioned, the "Big 8" U.S. accounting firms are dominant in the EC member states through local partnerships. The main EC competitors are local firms within the member states. Accounting firms in France and also in Spain are combining in order to compete more effectively with European offices of the international firms.

Accounting services are normally procured in open competition by qualified firms. The directive would allow accounting offices in member states to bid on contracts in member states in which they do not have offices. This opportunity for increased business could encourage additional investment by the international accounting firms. Such investment would probably be driven by positive market trends rather than by EC-value-added requirements since the Big 8 firms already service member-state markets through in-country affiliates, staffed by nationals.

Italy is considering not permitting the same accounting firm that provides auditing services to also provide management services and tax services. This measure could result in as many as three accounting firms being retained by any one entity. As the international accounting firms are interested in receiving contracts to provide all three services, this measure could harm the commercial interests of the Big 8 firms.

An individual certified public accountant (CPA) licensed in a U.S. State with reciprocity with the United Kingdom can apply for and receive a license in the United Kingdom. This individual may not be able to do the same in other EC member states.

U.S. Industry Response

The accounting firms with clients who may be bidding on public service contracts are analyzing the directives in order to advise their clients of the opportunities. They are also analyzing the directives to determine the opportunity for increased business for their own firms.

Discussions were conducted with partners of international CPA firms, an accounting trade specialist in another Government agency, and an executive director of an international accounting trade association. The directives would affect the operations of the accounting firms with offices in the member states and not necessarily affect international trade as related to the accounting profession.

Views of Interested Parties

No formal submissions were received.

Motor Vehicles

Possible Effects

U.S. exports to the EC

Current EC government-procurement practice tends towards EC suppliers. The greater transparency in procurement procedures called for in the directives could benefit U.S. companies. Total estimated value of EC procurement of motor vehicles in 1988 amounted to approximately 9.0 billion ECU.[97] Cars, trucks, and buses are the major items purchased.

The EC is the second-largest export market for U.S. motor vehicles after Canada and accounted for 6.9 percent of total U.S. exports in 1988, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	583
Japan	310
Canada	6,678
World	8,951

West Germany was the largest EC market, receiving 50.6 percent of U.S. motor-vehicle exports to the EC in 1988, followed by France, which received 17.2 percent, and Belgium, which received 10.3 percent of U.S. exports.

Diversion of trade to the U.S. market

The openness of the EC public sector market does not appear to be a significant factor influencing U.S. imports or investment. Furthermore, it is not anticipated that the directives would reduce the already inconsequential sales of non-EC firms to public purchasers in the EC. A change in the transparency of government procurement procedures in the EC is thus unlikely to cause diversion of third-country motor-vehicle exports to the U.S. market.

[97] This is based on a breakdown of public procurement of goods and services by product in 1984, in which the data for five countries (Belgium, West Germany, France, and the United Kingdom), were extrapolated to the EC 12.

U.S. investment and operating conditions abroad

Ford Motor Co. plans to invest $7.5 billion in Europe over the next 5 years. With 22 plants in Europe, sales of $17 billion, and profit of $1 billion, Ford intends to strengthen its position in anticipation of a newly integrated market economy. General Motors (GM) has also invested heavily in the EC; GM has six vehicle-assembly plants and 19 component-manufacturing operations there. GM's Automotive Components Group has established a specific European organization to coordinate GM's component activities in Europe and between Europe and the United States.

With respect to buses and coaches, the strong relationship forged between suppliers and operators would probably prevent nonnational suppliers from entering the market to any significant degree. There are more than 300 entities having more than 50 fleet vehicles operating urban and regional bus and coach services in the EC. Both operational expenditures and the investment plans of these entities are subject to extensive public supervision. Operational expenditures include such items as fuel, tires, and parts, and are generally procured locally. Because of the serious financial situation of many of the entities owning bus and coach services, capital investment has been limited to essential replacements.

Each EC country has its domestic supply industry for buses and coaches, and the industry is confined to supplying national markets or to extra-EC markets. The longstanding relationships between suppliers and operators have reinforced the existing separation of markets by the accumulation of company specifications and practices. A number of suppliers are publicly owned. A fear is that fair competition with national suppliers would not be possible after 1992. Potentially competitive suppliers exist in some European Free Trade Association (EFTA) countries and in Eastern European countries.

U.S. Industry Response

According to representatives of the U.S. automobile industry, the government procurement issue will not significantly affect U.S. automobile producers. Even with the transparency, various EC auto producers will remain national champions. Should the public procurement procedures open up, U.S. auto producers will still be competing with a service network of distributorships, dealers, and service companies belonging to EC automakers that is more extensive than that of the U.S. producers located in the EC. According to auto industry representatives, procurement is localized to the extent that in Stuttgart, the West German Government purchases Daimler-Benz motor vehicles, and in another part of West Germany,

the Government may purchase motor vehicles manufactured in that general area. Similarly, GM produces Opels in Frankfurt and can sell in that general area but usually cannot sell far from that area. The situation is thus very fragmented in each country, and according to U.S. automakers, and is not likely to change significantly.

Views of Interested Parties

No formal submissions were received.

Motor-Vehicle Parts

Possible Effects

U.S. exports to the EC

Motor-vehicle parts and accessories are normally procured through original-equipment manufacturers. Consequently, in light of warranty requirements, the procurement of aftermarket parts and accessories will continue to be tied to the sale of vehicles, despite the opening up of transport-sector purchasing. U.S.-based companies' success in acquiring EC public procurement contracts is likely to be closely tied to the success of U.S. automakers and their European affiliates in acquiring procurement contracts from EC governments.

These directives could provide additional marketing opportunities for non-EC suppliers of motor-vehicle parts and accessories; however, the potential for increased sales is limited and varies by commodity. For example, U.S. and Japanese parts suppliers will have an opportunity to compete for public-supply contracts to supply parts for EC trucks, buses, and coaches, which are the primary commodities affected by the opening of the transport sector. U.S. exports of parts to the EC during 1988 for commodities with the greatest potential for increased sales include engine parts ($128.3 million), transmissions ($99.8 million), tires ($58.4 million), air-conditioning equipment ($56.1 million), and braking systems ($47.7 million).

Total U.S. exports of motor-vehicle parts and accessories to the EC reached $1.4 billion in 1988. U.S. imports of parts from the EC amounted to $4.3 billion, resulting in a negative trade balance of $2.9 billion in 1988. The U.S. share of the EC market was estimated at 2 percent, or $40 billion in 1985. The U.S. share of the EC market remained at about 2 percent during 1986-88.

The EC is the second largest export market for U.S. motor-vehicle parts and accounted for 8 percent of total U.S. exports in 1988, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	1,366
Japan	429
Canada	10,826
World	17,473

Diversion of trade to the U.S. market

It is unlikely that opening the public sector market for motor-vehicle parts will result in a diversion of trade in these products from the EC to the U.S. market. With the possible exception of producers of those products discussed above, there is likely to be little change in EC procurement of motor-vehicle parts.

U.S. investment and operating conditions in the EC

Since the magnitude of expected benefit from these directives is small, U.S. firms are not likely to significantly increase investment in the EC and operating conditions will not be altered appreciably. According to the Bureau of Economic Analysis (BEA), there are 4 minority-owned and 89 majority-owned U.S. motor-vehicle parts affiliates operating in the EC. GM has 19 component-manufacturing operations in the EC. Ford Motor Co. is also a major exporter to the EC and has a number of manufacturing operations in the EC. These U.S.-owned firms have 19 major EC-based competitors that have secured almost all EC procurement contracts in recent years.

U.S. Industry Response

U.S.-owned parts manufacturers located in the EC will attempt to secure public-procurement contracts in the EC. Because of the concentration of U.S.-affiliated parts operations in the United Kingdom and West Germany, U.S.-owned firms are likely to bid on procurement contracts in these countries first.

Views of Interested Parties

No formal submission were received.

Aircraft

Possible Effects

U.S. exports to the EC

Despite the lack of a formal, open procurement policy in the EC, U.S. suppliers have been fairly successful in the EC market. In 1988, total U.S. aircraft and aircraft parts exports reached $18.2 billion. Of this figure, $5.9 billion went to the EC, representing approximately 32 percent of total exports. The supplies directive, as amended, specifically excludes "public supply contracts awarded by carriers by land, air, sea or

inland waterway" (art. 2a). The proposed directive on water, energy, and transport also exempts airlines from its scope. Therefore, 1992-related directives on procurement will have no influence on U.S. exports of aircraft to the EC.

Contracts let by EC airlines are almost exclusively let by companies whose operations are controlled by the governments of the respective countries, either through financial participation (British Airways in the United Kingdom is the exception) or by limiting access to air routes. There have reportedly been instances of procurement discrimination associated with attempts by some member states to support Europe's own aircraft-equipment suppliers, such as Airbus and Fokker.

Diversion of trade to the U.S. market

The adoption of this directive is likely to have no effect on the U.S. market for aircraft. The United States and the EC are the two major aircraft-producing areas in the world. The majority of aircraft sold in the world are made in the United States. Thus, diversion from third country suppliers is not anticipated.

U.S. investment and operating conditions abroad

The directive should not serve to increase U.S. investment in the EC. Current U.S. investment is minimal, as U.S. producers do not see an economic reason to locate in the EC. Generally speaking, it would not be in the EC's interest to restrict imports of aircraft. The United States is price and quality competitive with manufacturers in the EC, but has greater manufacturing capacity than the EC. The EC cannot produce enough aircraft to meet the demands of their carriers. Furthermore, there are no other major manufacturers in the world who compete with either the U.S. or the EC.

U.S. Industry Response

U.S. producers are likely not to take any specific actions in response to this directive. Should they gain access to public-supply contracts, U.S. suppliers are unlikely to gain anything more than they have now, as they already have this access in reality and should have it for the foreseeable future because of their capacity and technical expertise in building aircraft.

Views of Interested Parties

No formal submissions were received.

Locomotives and Rolling Stock

Possible Effects

U.S. exports to the EC

Opening up EC public procurement per se is unlikely to affect U.S. exports since design differences between the EC and the United States, as well as among the EC member states, are the primary barrier to cross-border trade in this sector. For example, railway authorities in the EC generally purchase electric locomotives, which the United States does not produce. Even within the EC, public purchases are obtained largely from domestic sources because of differences in track gauge and voltage.

Development of new models in the EC is often done jointly by the national railway administrations and their traditional suppliers. This practice makes it difficult for other suppliers to win orders. (An exception is British Rail, which has a policy of competitive procurement and which has invited the U.S. firms GM and GE to bid on contracts.) Geographical proximity, along with a common language and industrial culture, often work to the advantage of traditional suppliers. Since government procurement in the EC appears to be responding to technological changes, however, it is possible that development of the next generation of locomotives will be across borders, thus creating opportunities for increased trade.

Total U.S. exports of locomotives and rolling stock to the EC were $21 million, or 7 percent of the U.S. locomotive industry's total exports in 1988. U.S. exports to the EC of locomotives and tenders were $11 million, or 19 percent of total U.S. locomotive and tender exports. France and Italy were the primary purchasers. U.S. parts exports to the EC were $8 million in 1988. U.S. exports to the EC of railway cars and service vehicles, including self-propelled, accounted for the remaining $2 million in U.S. exports in 1988, or 4 percent of total U.S. exports of rail cars and service vehicles.

Major U.S. suppliers include GM and GE for locomotives and Thrall Car, Trinity Industries, Gunderson, and Bethlehem Steel's Freight Car Division for cars. Parts for locomotives and cars are extremely varied and are supplied by different types of manufacturers, including manufacturers of steel castings, electrical parts manufacturers, and manufacturers of mechanical parts such as Westinghouse Brake and Signal. A large number of U.S. companies perform remanufacture and rebuild work on locomotives and cars, including Morrison-Knudsen, but few U.S. firms are involved in such work overseas; proximity is an important factor in this type of service.

Railway contracts typically involve 2 main suppliers, one each for mechanical and electrical

parts. These suppliers usually rely upon subcontractors for subassemblies, such as bogies and braking systems. U.S. firms have sold some such equipment and services in the EC, but the purchaser is usually the domestic manufacturer, not the railway authority itself. The EC market for parts and cars is larger than the market for locomotives. Between 80 and 90 locomotives were purchased by buyers in the EC in 1987, compared with approximately 500 in the United States.

Europe is the world's largest manufacturer of railway rolling stock, with enough production capacity to meet entire world demand. Whereas there is an export market for diesels, metros, and multiple units produced in the EC, EC manufacturers rely primarily on domestic markets for sales of electric locomotives, since other continents do not have extensive electrified mainline networks. With the exception of Greece, Ireland, Luxembourg, and the Netherlands, each EC member state has its own railway supply industry with which the national railway authority maintains close ties.

EC firms producing locomotives or parts include Alsthom of France, the lead supplier to the French national railway, SNCF. Alsthom owns half of ACEC in Belgium, works together with Germany's MAN for diesel locomotives, and is a key member of the 50 c/s Group (with AEG, Siemens, and BBC), which has agreed to share export contracts. Other producers are ACEC (electrical parts) and BN (mechanical parts) of Belgium. German producers of mechanical parts include Thyssen Henschel, Krupp Mak, and Krauss Maffei. German producers of electrical parts include Siemens, AEG, and BBC Aktiengesellschaft (AG). Italy's major producers of complete locomotives include Fiat Ferroviaria and Breda. Ansaldo Transporti, Brown Boveri, and Magneto Marelli make electrical parts. The rail-equipment industry in the United Kingdom is fairly diversified: Brush Electrical Machines is an integrated manufacturer of locomotives, but is a part of the larger Hawker Siddley Group, which includes Westinghouse Brake and Signal. Metro Cammel has historically produced metro trains but has recently bid for diesel locomotives. GEC (electrical) and BREL (mechanical) commonly work together.

The United States imported 123 million dollars worth of locomotives and rolling stock from the EC in 1988, 30 percent of total U.S. imports in that category. Imports from all sources account for at least 30 percent of the U.S. market for locomotives and rolling stock. European manufacturers are also important suppliers in the U.S. market for parts and rail cars.

Diversion of trade to the U.S. market

Adoption of these directives is unlikely to lead to diversion of third-country exports to the U.S. market because different products are sold in the United States and the EC. The principal third-country suppliers are Canada (Bombardier) and Japan (Fuji Electric, Mitsubishi Heavy Industries). Neither country currently has significant sales in the EC market for locomotives and rolling stock.

U.S. investment and operating conditions in the EC

The directive should not serve to significantly increase U.S. investment in the EC. Current U.S. investment is minimal, since U.S. producers do not see an economic reason to locate in the EC.

U.S. Industry Response

U.S. producers have not indicated any specific actions in response to these directives, as the magnitude of their effects is not yet clear.

Views of Interested Parties

No formal submissions were received.

Coal

Possible Effects

U.S. exports to the EC

The United States leads the rest of the world in total reserves and production of coal, accounting for about 28 percent of the world's total recoverable reserves and 21 percent of the world's production of coal. Approximately 37 million short tons, or 40 percent of total U.S. exports, were slated for the nations of the EC. Other major markets for U.S. exports of coal are Canada and Japan.

The United States supplies about 30 percent of the EC's demand for coal. Because of their high value as an energy source (steam coal) as well as their use in the production of coke (metallurgical coal) bituminous and lignite coals are the major coals exported from the United States to the EC. The primary consumers of such coals in the EC are electric utilities. However, purchases of coal by electric utilities will not be covered by the EC's proposed directive on water, energy, and transport. Furthermore, as noted above, such utilities are presently not obliged under the GATT to open up their contracts to U.S. participation. Thus, the directive, as presently framed, is not expected to have an impact on U.S. coal exports. Should U.S. firms obtain access to the EC public sector market, they would be likely to increase their exports.

Diversion of trade to the U.S. market

Other major suppliers to the EC market are South Africa (20 percent), Australia (16 percent), and Poland (15 percent). Other smaller suppliers to the EC are the Soviet Union, Canada, and Colombia. As stated previously, the United States leads the world in terms of both recoverable reserves and production of coal. U.S. imports account for less than 1 percent of domestic consumption. The United States is also a major world exporter of coal. Therefore, coal exports from third nations are unlikely to be diverted to the U.S. market as a result of changes in the EC's policies.

U.S. investment and operating conditions in the EC

There is little or no U.S. investment in coal mining in the EC. For reasons of national security, the governments of the EC nations play a major role in their coal industries. Production of coal in the EC is centered in the United Kingdom, which accounts for about 46 percent of the coal produced in the EC, and West Germany, which accounts for 38 percent. Small amounts of coal are produced in France and Spain, which together account for less than 13 percent of total EC production of coal.

In the United Kingdom, the nationalized company British Coal (formerly the National Coal Board), has a 90-percent monopoly on coal production. The remaining 10 percent is mined by small companies licensed by British Coal.

West Germany has nine coal companies, the two smallest of which (DR Arnold Schafer and Merschweller Bewerksgesellschaft) are privately owned; the others (Ruhrkohlenwerke AG, Saarbergwerke, Eschweller Bewerks-Verein AG, August Victoria, Sofia Jacoba, Preussag Kohle, and Rheinische Brunkohlenwerke AG) are held by conglomerates in association with federal or regional authorities.

Both West Germany and the United Kingdom maintain price agreements and subsidies that enable the electric utilities to purchase domestically produced coal, the production cost of which exceeds world coal prices; electric utilities in these nations agree to purchase a minimum amount of domestic coal. However, domestic production does not meet this demand, and both nations must import coal.

In France, the nationalized company, Charbonnage de France, controls all coal production. In Spain, the market is shared by more than 200 companies, half of which are nationalized. The largest company, Hunosa, is nationalized and accounts for more than 90 percent of total production.

There is little intra-EC trade in coal. The transportation costs associated with moving Britsh coal from the mines to the Continent are prohibitive. As a result, imports from third countries, primarily the United States, satisfy the demand for coal in these EC nations.

U.S. Industry Response

It is unlikely that these directives will result in any changes in the U.S. coal industry's operations, as the EC market is already dependent on U.S. exports of coal. However, industry is beginning to investigate possible trade liberalizing effects of 1992-related directives and other EC policies, such as the creation of an "internal market for energy."

Views of Interested Parties

No formal submissions were received.

Heavy Electrical Equipment

Possible Effects

U.S. exports to the EC

In the short run, directive 88/377 is not likely to provide any increased trade opportunities for U.S. suppliers of these products. Since 1960, U.S. producers have sold virtually no heavy electrical equipment to purchasers in the current EC member states. According to U.S. industry representatives, this situation has resulted from a concerted effort on the part of procurement entities in the EC to purchase equipment from indigenous suppliers, e.g., CGE/Alsthom (France), Siemens/Kraftwerk Union AG and BBC AG (West Germany), Ansaldo and Franco Tosi (Italy), and GEC and NEI Parsons (United Kingdom). Significant excess production capacity for the production of heavy electrical equipment also currently exists in both the EC and the United States.

Sales of heavy electrical equipment are typically consummated on the basis of an intricate bidding process. Under a completely transparent public-bidding scenario, prospective suppliers would be apprised of the type of equipment that the procuring authority is planning to purchase. The purchaser would also provide those suppliers that it deems technically capable of producing the subject equipment with a precise engineering prospectus. This prospectus would outline in detail the technical specifications and design characteristics required of the individual piece of equipment. Because of the highly technical nature of these products and the large sums of money involved in most sales contracts, the cost to the potential supplier of submitting a bid proposal to the potential customer can be $100,000 or more. Thus suppliers do not submit bids on this equipment unless they are reasonably certain that they are on a competitive footing with the other bidders and that their bid will be evaluated on a purely objective basis.

According to U.S. industry sources, the bidding process in many EC markets is closed to outside suppliers. Historically, U.S. suppliers, most prominantly General Electric Co. and Westinghouse Electric Corp., have either not received adequate notice of prospective equipment purchases, have been discouraged, or asked not to bid on contracts, or, in cases where they have submitted unsuccessful bid proposals, have not been provided with any indication of why their bids were not accepted. Current EC proposals to increase the transparency of procurement among its member states would not in any way be expected to guarantee increased access to these markets by U.S. suppliers. They would, nonetheless, move the procurement process out into the open where U.S. industrial interests could begin to make the case, which they cannot adequately document now, that EC markets are essentially closed to outside suppliers. Thus, the long-term effect of current EC directives may be to justify a stronger push on the part of the U.S. Government to insure equivalent access for U.S. heavy electrical equipment producers in EC markets.

On the negative side, the effect of EC procurement guidelines may be to strengthen the competitiveness of EC suppliers. Forcing a more competitive environment on current EC suppliers could result in the demise of marginal suppliers that are currently the beneficiaries of protected home markets and guaranteed supply contracts. By accelerating the rationalization of heavy electrical equipment production in the EC, the new procurement guidelines may result in suppliers that are leaner and consequently more competitive in EC and world markets. Such a situation could not only imperil U.S. suppliers' access to EC markets but also lead to an erosion of U.S. product markets.

Diversion of trade to the U.S. market

At present, the principal third-country sources of heavy electrical equipment to the EC are, in approximate order of importance, Switzerland, Sweden, Austria, and Japan. Due to the fact that suppliers in the first three source countries (Asea Brown Boveri Ltd., Switzerland; Asea AB, Sweden; BBC, Austria) are intimately linked through multinational operations to producers within the EC, EC directive 88/377 is not expected to significantly alter current trade patterns and thus create the potential for the diversion of equipment to the U.S. market. Such suppliers are well placed to derive scale economies from the single European market, are less likely to face technical obstacles, and have lower shipping costs.

With respect to shipments of Japanese equipment to the EC, most of which were power circuit breakers and gas turbines, minimal trade diversion is also anticipated as the result of EC directives. This is due to the fact that EC imports from Japan to date have been relatively insignificant. In addition, any diversion of trade in power circuit breakers would have no adverse effect on U.S. producers, since these products are no longer produced in the United States. The principal Japanese producers of this equipment are Hitachi, Mitsubishi Electric, Toshiba, and Fuji Electric.

In 1987, U.S. imports of heavy electrical equipment from Japan amounted to approximately $88 million. Approximately 30 percent of these entries were of power circuit breakers. The remaining imports were composed largely of steam turbines and parts and large power generators.

U.S. investment and operating conditions in the EC

EC directive 88/377 is not expected to have an immediate impact on U.S. investment in the EC. The perceived threat of the integration of EC markets and the evolution of a "fortress Europe" scenario has, however, prompted one U.S. manufacturer to enter into a joint-venture agreement with two EC producers of heavy electrical equipment. This development has been described by numerous industry sources as a "foot in the door" action that may eventually lead to a significant investment of U.S. capital in Europe. Many U.S. industry representatives are currently viewing the imminent integration of EC markets as a warning to the major world producers of heavy electrical equipment that should various EC markets be thrown open to competition competitive, a major shakeout could take place. Considerable excess production capacity already exists in Europe, so a more competitive environment in the EC is almost certain to involve significant internal consolidation. Anticipating this rationalization process, the major players in Europe have already begun to establish alliances and some major mergers and acquisitions have been accomplished or are being formulated, e.g., Asea/BBC Brown Boveri, Siemens/Kraftwerk Union AG, General Electric Co. (U.S.) and GEC of the United Kingdom.

U.S. Industry Response

The U.S. industry and its major trade association, the National Electrical Manufacturers Association (NEMA), have been closely monitoring the progress that the EC has been making towards developing and implementing standards and government procurement directives. NEMA has made some significant attempts to become involved in the establishment of European standards affecting heavy electrical equipment through participation in the activities of the standardsmaking bodies CEN and CENELEC. Beyond these endeavors, the industry

is still contemplating a variety of possible responses.

Views of Interested Parties

No formal submissions were received.

Boilers

Possible Effects

U.S. exports to the EC

The directive on water, energy, and transport ((88) 377) is expected to have little effect on the trade position of U.S. boiler manufacturers. World demand currently lags far behind production capacity. This is due in large part to the lack of new orders for large powerplants and the switch to alternative sources of energy generation. Most U.S. boiler manufacturers have consolidated operations and have become more involved with the refurbishing side of the business rather than with the installation of new boiler systems. In Europe, the situation is more severe, because many small firms are competing for relatively few contracts each year. As a result, several EC countries supply most of the EC's needs, making the EC market very difficult for U.S. producers to enter.

As demand has declined and companies could no longer survive by servicing and maintaining existing equipment, export markets have become very important to U.S. boiler manufacturers. However, many U.S. firms report not having obtained a European contract for at least the last 4 years. Instead, they compete with EC firms in third markets, mainly developing countries, where, according to industry sources, Europeans can afford to place low bids for contracts because of the higher prices they maintain at home in a closed market.

World production and consumption of boilers are concentrated in the United States, the EC (especially the United Kingdom, France, West Germany, and Italy), Sweden, Switzerland, and Japan. Trade among these countries remains extremely limited, and imports into each are negligible. Even the major EC producers do not trade with one another, although all compete for business within the smaller European markets. EC markets that have no notable domestic boiler industries include the Netherlands, Greece, and Portugal.

U.S. exports of boilers have been depressed for the last decade. Although the weaker dollar has helped the industry to be somewhat more competitive since 1987, the low level of demand is not expected to change before the early 1990s. During the period 1984-88, U.S. exports declined by an average annual rate of just under 2 percent, to approximately $263 million in 1988. The EC's share of the total value of U.S. exports remained fairly constant during these years, at about 5 to 7 percent. U.S. exports to the EC accounted for about 1 percent of the total value of U.S. industry shipments in 1988. The EC was the second-largest export market for U.S. boilers in 1988 as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	14.0
Japan	5.3
Canada	48.2
World	263.0

Diversion of trade to the U.S. market

The directive is not likely to result in diversion of trade to the United States in the area of boilers. The worldwide slump in demand means that any non-EC supplier continues to present a potential threat to domestic EC suppliers. With an industry consisting mainly of medium-sized, inefficient producers, Europe, in the face of massive overcapacity, must protect its internal markets from foreign competitors. Third-country suppliers, such as Japan, Korea, India, and China have been especially threatening because of their more cost-efficient production methods and their low labor costs.

In the U.S. market, these third-country suppliers are already present and have traditionally competed with U.S. firms—sometimes even forming joint ventures so that both may compete effectively. Exports into the United States from third-country suppliers are not likely to exceed present levels and are not expected to be a result of exclusion from the EC market to any greater degree than they have been in the past.

U.S. investment and operating conditions in the EC

If the directive is adopted and U.S. boiler manufacturers were to receive more contracts, they may be inclined to invest more in European production facilities. In addition, U.S. firms could submit a greater number of bids for public-procurement contracts. However, in light of worldwide market conditions, it is not expected that U.S. industry will be more involved in EC procurement. The few new orders are likely to be filled by firms from the EC.

U.S. Industry Response

U.S. boiler manufacturers are typically large, multifaceted operations that produce other heavy electrical equipment and do not rely solely on their boiler trade for business. Should the market improve somewhat—something industry and energy experts do not expect before the early 1990s—possible actions may be considered. Given

the present state of the boiler industry, however, it is perhaps somewhat early for U.S. manufacturers to consider immediate responses to the directive and their position in the EC boiler market.

Views of Interested Parties

No formal submissions were received.

Water-measuring and Water-control Instruments and Systems

Possible Effects

U.S. exports to the EC

Whereas the directives will make it easier for companies located in the EC to bid on contracts within the EC, U.S. entities that do not have subsidiaries in the EC will not benefit from the provisions of the directives.

As in the past, U.S. exporters of water-measuring and water-control instruments and systems to the EC will continue to face a host of disadvantages should the directives be adopted. Historically, in each of the EC member states national suppliers have been favored by municipal water utilities. Approximately 60 to 80 percent of the instruments and systems procured by EC water utilities are of national origin. It is believed that U.S. exports of such instruments and systems to the EC accounted for about 1 percent of total EC consumption in 1988 (about $10 million). The largest share of U.S. exports to the EC is made up of liquid consumption meters, and the second-largest portion consists of parts and components purchased by U.S. subsidiaries in the EC producing water-measuring and water-control instruments and systems for EC water utilities. U.S. exports of water-measuring and water-control instruments and systems include instruments and systems that are used for management of water stock, supply of drinking water, purification of waste water, aquatic recreational activities, and irrigation purposes.

A number of factors contribute to the relatively small volume of U.S. exports of water-measuring and water-control instruments and systems to the EC. The primary purchasers of the products consumed by the EC water utilities are local, regional, or provincial authorities that operate the water utilities under their own authority, or delegate their authority to associations or public, private, or mixed enterprises. The exclusive rights granted by public authorities to municipal water utilities gives them de facto procurement monopolies in certain geographical regions. These water utilities are therefore able to decide whether procurement should be conducted by means of open competition, qualified supplier(s), negotiated tender, or contractors' bid. Normally, for medium and large projects, for which the leadtime between identification of needs and contract award may be up to 3 years, a good deal of design work is performed by potential suppliers, thereby enabling them to influence the type of instruments and systems that may be integrated into the project. After-sale service and ongoing engineering support also generally favor the local supplier(s). This is because instruments and systems, including parts and components, produced by different manufacturers typically are not interchangeable. Therefore, most followup orders are awarded to the initial suppliers(s).

In 1988, U.S. production of measuring and control instruments and systems for water utilities is estimated to have reached $600 million, and U.S. exports of these products to the EC member states are believed to have reached $10 million, or about 2 percent of total U.S. production. In the same year, total U.S. exports of water-measuring and water-control instruments and systems were estimated at $80 million, accounting for 13 percent of total U.S. shipments. U.S. exports to the EC accounted for 13 percent of total U.S. exports.

Diversion of trade to the U.S. market

It is believed that diversion of trade to the U.S. market will not be significant. Third countries are not major suppliers of instruments and systems to the EC water utilities. In addition, the designs and technical requirements for instruments and systems that are used by EC water utilities differ markedly from those used by U.S. water utilities. Also, historically, the U.S. water-utility industry has not been a fertile market for foreign-made measuring and control instruments and systems, because most U.S. water utilities prefer to deal with their primary domestic suppliers to assure after-sale service and ongoing engineering support.

U.S. investment and operating conditions in the EC

U.S. investment in the EC appears to be substantial. At least three U.S. producers of instruments and systems for the municipal water-utility market have production facilities in the EC. One of the companies has seven production facilities in different EC member states. The directives do not contain provisions that may adversely affect U.S. investments and operating conditions in the EC, provided the subsidiaries are able to meet the 50-percent local-content requirement. Firms that do not currently meet 50 percent EC value added are likely to increase their local sourcing. The creation of a single market in the EC may encourage U.S. companies to expand their existing production facilities in the EC in order to achieve greater economies of scale. Also, some U.S. subsidiaries in the EC may consolidate some or all of their facilities. Because the directives, if adopted,

could make it more difficult for U.S. producers to export water-measuring and water-control instruments and systems to the EC, it is likely that more U.S. producers will establish production facilities in the EC in order to penetrate the EC market.

U.S. Industry Response

U.S. producers of water-measuring and water-control instruments and systems that have production and distribution facilities in the Community will have no problem meeting the 50-percent local-content requirement, since most already meet this provision of the directives. The one U.S. subsidiary that does not meet this requirement at this time reports that it will do so when the directives become law.

Views of Interested Parties

No formal submissions were received.

Chemicals for Water Treatment

Possible Effects

U.S. exports to the EC

The current levels of U.S. exports to the EC in chemicals for public/municipal water treatment are very low. Calcium oxide (quicklime), aluminum sulfate, and chlorine are the most important water-treatment chemicals purchased by EC public/municipal water-procurement entities.

The United States competes in the EC public municipal market for chemicals for water treatment through direct investment in the EC, rather than through exports. Sales by U.S. firms established in the EC market accounted for an estimated of 5 to 10 percent of a total EC municipal market for chemicals for water treatment estimated at approximately $50 million (i.e., approximately $2.5 million to $5 million dollars). This market share is on a par with U.S. performance in world markets, where U.S. suppliers hold an estimated 5 to 10 percent share. The total world market for chemicals for municipal water treatment is estimated to be about $650 million.

Diversion of trade to the U.S. market

It is unlikely that the directive will result in any diversion of third-country exports from the EC to the United States, since most third-country suppliers rely upon production in the United States to serve the U.S. market. U.S. imports of chemicals for municipal water treatment, like exports, are very low. The total U.S. market for chemicals for municipal water treatment is estimated to be approximately $350 million. The EC direct-investment market share in the U.S. market is estimated to be approximately 25 percent of the U.S. market for chemicals. Japan is thought to be the major third-country supplier of chemicals for municipal water treatment.

U.S. investment and operating conditions in the EC

Directives 88/376 and 88/377 may open up opportunities previously closed to U.S. subsidiaries in the EC and thus result in an increase in U.S. sales. However, the 50-percent local-content rule, coupled with the 3-percent EC preference, will probably continue to serve as an effective export deterrent and direct-investment enhancement. U.S. industry sources say that a company just about needs to open an office in every municipality to obtain qualification to bid for municipal contracts for chemicals for water treatment. U.S. firms successfully sold equipment and services to such EC entities with a direct-investment municipal presence, basically turnkey plants with follow-on purchases of chemicals for supplies. Discrete sales of chemicals for municipal water treatment are not aggressively pursued by U.S. firms operating in the EC.

The major U.S. companies that compete in the EC for market share of chemicals for municipal water treatment are Calgon, Nalco, Betz Laboratories, Ashland Chemical, and W.R. Grace. The major EC companies that compete in the EC for market share of municipal chemicals for water treatment are Allied Colloids of the United Kingdom, Floerger of France, and Stochhousen of West Germany. Production and sale of chemicals for municipal water treatment is thought to be a static rather than a dynamic industry.

U.S. Industry Response

It may be helpful to try to put the significance of the chemicals used for municipal water treatment into an overall water-treatment industry perspective. Within the water-treatment industry, the industrial or private sector is the most important. This portion encompasses such markets as boiler feedwaters, cooling waters, and process waters used in a multitude of extremely diverse industries. The relatively minor municipal water-treatment sector essentially deals with the public drinking water supply and sewage treatment. Within the entire water-treatment industry, plant, equipment, and technology account for the major portion of revenue earned. Chemicals for water treatment are just a follow-on and are not considered a major revenue earner. This is true both within the major industrial water-treatment sector and in the minor public/municipal water-treatment sector. Therefore, chemicals for public/municipal water treatment are a minor portion of a minor industry sector.

Industry sources indicated that the EC municipal sector of the chemicals for water

treatment market is minor relative to the comparable industrial market. U.S. industry is currently studying these directives; however, no major changes in the U.S. approach to business within the EC market for chemicals for public/municipal water treatment are forecast at present as a result of EC 1992.

Views of Interested Parties

No formal submissions were received.

Valves, Pumps, and Compressors

Possible Effects

U.S. exports to the EC

Directive 88/377 is most likely to have a neutral impact on the U.S. industry producing pumps, valves, and compressors (air and gas) for the EC. U.S. exports of these products amounted to approximately $239 million in 1988. The bulk of U.S. exports of these products to the EC consisted of various types of valves and parts ($156 million) for water and waste-water systems. U.S. exports of compressors and pumps for liquids collectively amounted to $83 million during this period. The U.S. market share for these products is approximately 15 percent of the total EC import market.

At present, the U.S. industry producing valves, compressors, and pumps does not maintain a large presence in the EC. The bulk of U.S. firms producing these products rely on exports to supply this market. Producers of these products are primarily medium- and small-sized firms. The procuring entities in the United Kingdom, France, and West Germany are considered to be the largest and most centralized of the 12 EC nations. Procuring entities in other EC member nations are small and decentralized.

The EC is the second-largest export market for valves, compressors, and pumps after Canada and accounted for 15 percent of total U.S. exports in 1988, as shown in the following tabulations (in millions of dollars):

Market	*U.S. exports*
EC	238
Japan	74
Canada	362
World	1,550

During 1984-88, U.S. exports of valves to the EC increased from $130 million to $156 million, or by 20 percent. During this period, U.S. exports to the world also increased from $673 million to $798 million, or by 19 percent. U.S. exports of air and gas compressors and pumps to the EC increased marginally, from $79 million to $83 million, or by 5 percent from 1984-88. However, U.S. exports of these products to the world increased from $588 million in 1984 to $752 million in 1988, or by 28 percent. In 1988, U.S. exports of these products accounted for 8 percent of total U.S. production.

The principal foreign export markets for valves, compressors, and pumps during 1988 were Canada, Mexico, and Japan. Collectively, these three nations accounted for 45 percent of total U.S. exports of these products. Although the United States is the world's largest producer of all these products, presently, numerous countries are emerging as major producers. The EC (principally West Germany and Italy) accounts for an estimated 30 percent of total world production. The United States and the EC collectively maintain an estimated 75 percent of the world market share for these products.

Diversion of trade to the U.S. market

Directive 88/377 is most likely to have a neutral impact on U.S. imports primarily because this directive is not expected to cause a decrease in EC imports.

Although Japan is a major world supplier of these products to the world, it is not a major supplier of valves, compressors, and pumps employed in the EC waterworks projects. Japan's production of these products is largely concentrated in petroleum production and refining and other industrial applications. The extent of any diversion of Japan's EC-bound trade to the U.S. market is most likely to be insignificant. In recent years, Taiwan has emerged as a major world producer of valves used in these types of water and sanitationprojects. Nearly all other third-country suppliers of these products can be considered insignificant in any possible trade diversion to the United States.

The aggregate value of U.S. imports of valves, pumps, and compressors increased by 135 percent, from $931 million in 1983 to $2.1 billion in 1987. Principal supplier nations were Canada, Japan, West Germany, and Taiwan; collectively, these countries accounted for nearly 70 percent of the total value of U.S. imports in 1987.

U.S. investment and operating conditions in the EC

To date, U.S. firms have been hampered by various technical factors and restrictive purchasing procedures in the EC that discourage further penetration of this market. Industry sources indicate that EC member states, on average, procure less than 2 percent of government requirements from nonnational suppliers. Secondly, the bulk of demand for waterworks projects is for replacement parts. However, the trend towards privatization of local public services should also lead to a growing market with such entities (e.g., the United Kingdom and the Netherlands). The anticipated

opening of water-supply markets is likely to provide ample opportunity for each nation's industry and increased competition, even if initially there is no overall increase in product demand.

This directive will probably have two distinct effects on U.S. producers of these products. Large producers of valves, compressors, and pumps are likely to benefit from serving a much larger potential market with less technical restriction, and at the same time realize economies of scale. Those firms with European operations are most likely to incur less stringent administrative and operating expenses. This directive is likely to encourage U.S. producers of these products to increase manufacturing investment in the EC. On the other hand, small and some medium-sized producers may not be able to afford the high cost of establishing facilities in the EC. These firms are likely to remain dependent on exports and are likely to face more stringent national-content requirements. Nearly all medium and small U.S. producers of these products contacted indicated that they are likely to continue to attempt to export or enter joint-venture agreements with European firms.

In 1987, U.S. direct investment in the EC for pumps and compressors amounted to $430 million. Industry sources indicate that this level should increase substantially as a result of the 1992 EC integration. However, all sources agree that they will probably incur a great deal more intra-EC competition in the near future.

U.S. Industry Response

Nearly all firms not already operating in the EC voiced concern regarding the possibility of incurring discriminatory practices such as having to comply with discriminatory procedures and technical standards.

The American Hardware Manufacturers Association (AHMA), which represents manufacturers of consumer products, will present its views regarding export opportunities and potential trade barriers to the association's member firms.

Views of Interested Parties

No formal submissions were received.

Water Pipes, Tubes, and Flanges

Possible Effects

U.S. exports to the EC

Water-transport systems employ pipes and flanges made from a variety of materials, including steel, plastic, cast iron, and copper; not all types of products are exported to the EC from the United States. In 1988, copper pipes and fittings were the largest category of exports, accounting for $10 million out of a total of $12.9 million in U.S. exports to the EC. These export levels were 66 percent higher than those in 1984, due in large part to exchange-rate shifts during the period. The EC is a relatively small export market for U.S. manufacturers of these products, representing about 12 percent of all exports in 1988, as shown in the following tabulation (in thousands of dollars):

Market	*U.S. exports*
EC	12,869
Canada	29,399
World	108,008

Although the increased transparency required in the directives appears to be trade liberalizing, significant increased entry of U.S. producers into the EC is not anticipated. There are several reasons for this. Most important, industry sources note that, regardless of the type of product, most U.S. exports of water pipes, tubes, and flanges to the EC are sold to distributors or European contractors rather than directly to purchasing government entities. Therefore, there will be little direct impact on the majority of U.S. manufacturers of these products.

In addition, U.S. manufacturers of products intended for the EC market must be tooled to produce metric-sized fittings, flanges, or pipes. These additional expense and control requirements may discourage smaller firms from pursuing EC export markets.

Diversion of trade to the U.S. market

There is no other source exporting to the EC market that would be likely to shift product to the United States as a result of these directives. Within the EC, most pipe, tube, and flange products for water systems are supplied by local companies. For example, the primary suppliers of steel products used in such projects are Mannesmann Pipe and Tube (West Germany), British Steel (Great Britain), and Pont-a-Mousson (France). There are numerous smaller suppliers of plastic, copper, and concrete pipes. In addition, both in the EC and the United States, local sourcing is preferred for several reasons, including the high quality of domestic products, the transportation costs involved in shipping pipe, and the need for after-sales service.

U.S. investment and operating conditions in the EC

U.S. pipe, tube, and flange products for water systems are typically sold to European distributors or contractors; at this time, there are no known U.S.-owned manufacturing operations in the EC. At least one U.S. company will be opening a

European distribution facility, however. This action is intended to establish a European presence prior to 1992, in order to take full advantage of potential markets.

Several industry sources indicated that currently, the largest obstacle to operating in the EC is the necessity to meet a variety of standards-certification requirements. Although once obtained, such certification may be acceptable to a variety of government entities throughout the EC, individual strictures vary between countries.[98]

U.S. Industry Response

Several companies indicated that they are working with those certification entities whose requirements are most likely to be adopted as EC-wide standards in 1992. The intention is to assure that those standards that are adopted correspond as closely as possible to the product specifications for which the company is currently tooled.

Industry sources anticipate some EC market expansion for their products post-1992. Several have indicated that they feel the key to capitalizing on such future opportunities is to establish a presence in Europe now, and, when possible, to work closely with those organizations whose certification standards may be adopted in the future.

Views of Interested Parties

No formal submissions were received.

Data Processing Services

Possible Effects

U.S. exports to the EC

The United States provided more than 70 percent of the world's data processing services, or $30 billion, in 1987. The United States is also the world's largest supplier of software and software programs. The strong U.S. position in the sale of software is related to the dominant position of U.S. firms in the manufacture and sale of computers and other office machines. Approximately 70 percent of the U.S. software industry revenues of $20 billion in 1987 came from sales of packaged software, with foreign sales accounting for almost 40 percent of total revenues. U.S. suppliers of electronic database services are strong competitors in many foreign markets because English is widely used in international transactions.[99]

[98] Industry sources indicate that some EC countries apply certification requirements in a manner "which suggests protectionist considerations."

[99] All figures estimated by the staff of the U.S. International Trade Commission.

Both directives appear to be trade liberalizing. Com(88)378 governs procurement of software service contracts, among other things, by the public telecommunications authorities/providers in the member states. This directive specifically addresses the issue of software since it is such an important element in the new telecommunications technologies. Many modern telecommunications services are controlled by software contained in network-switching systems. Since U.S. software firms are among the most competitive in the world, it is likely that they will win a number of these software contracts when they are opened up to public bidding.

However, this increase in U.S. sales is unlikely to come in the form of direct U.S. exports. U.S. firms tend to service the EC market through direct investment rather than exports. In 1987, about $22 billion, or 35 percent, of the computer and data processing service industry's total revenues were derived from foreign sources. Direct exports are believed to account for less than 5 percent of the industry's foreign revenues. Bureau of Economic Analysis (BEA) data indicate that total U.S. sales of computer and data processing services to unaffiliated foreigners were only $985 million in 1986. The bulk of foreign revenues comes from intracompany transactions. Also, the EC 12 accounted for only $111 million, or 11 percent, of this total.

Diversion of trade to the U.S. market

No significant diversion of trade to the U.S. market is anticipated. The United States is the world's largest market for programming, software, and data processing services, and U.S. firms are the largest suppliers. BEA data for 1986 show that unaffiliated U.S. firms purchased only $32 million in computer and data processing services from the rest of the world, and of this total, $20 million came from the EC.

Foreign firms have only a limited participation in computer and data processing and software services. The U.S. leadership in these services begins with the vast U.S. domestic market driven by a hardware base that is the world's largest. U.S. firms can recoup their design and development costs in the United States, giving them additional flexibility for competing for sales in foreign markets. The United States is attracting foreign investment in software and programming services and electronic database services. The level of investment is small and is related to the desire of foreign firms to improve their small share of the world market for these services. Generally, these foreign firms have entered the U.S. market through acquisition. European software firms currently have a greater presence in the United States, but over the long run, Japanese firms are likely to emerge as the primary competitors to U.S. firms. This is because Japanese computer producers offer equipment

that compares favorably with that offered by U.S. firms. However, Japan lags well behind U.S. firms in applications software developments and is thus handicapped in hardware sales.

U.S. investment and operating conditions in the EC

U.S. computer and data processing services firms operate in the EC similarly to firms in the United States. They have established service facilities in all of the larger member states and have set up telecommunications networks to interconnect these facilities and their customers. These firms provide onsite or remote processing, report preparation, and custom programming. The U.S. computer and data processing industry has three major segments: (1) programming services, (2) data processing services, and (3) other computer-related services, including computer rental and leasing and electronic data base services. In 1987, revenues for the U.S. computer and data processing industry were valued at $62 billion. Programming services and data processing services each accounted for about 40 percent of total revenues with other computer-related services accounting for the remaining 20 percent.[100]

If the directives liberalize the procurement process, the return on investment in the EC in these industries may increase and thus encourage additional investment. The question of how procuring entities will value computer software for the purposes of implementing the directive is unclear at this time. EC thinking on the matter should become clearer as work on a generic "services" directive progress. Valuation of software is important not only in terms of determining EC content, but in determining what types of obligation purchasers have. If a contract is classified as a software services contract, entities are given greater freedom to directly negotiate with one or several suppliers. On the other hand, all covered software services contracts are to be opened to EC-wide competition by 1990, 2 years before equipment contracts.

U.S. Industry Response

The U.S. computer and data processing industry, individually and collectively through its associations, is more concerned with what the EC will do to and with an EC-wide telecommunications policy. Since many of the services provided by the industry are transmitted over telephone lines, any change to an EC-wide telecommunications policy that is more restrictive than the existing regimes in the member states will hamper their ability to deliver their services. Further, according to industry spokesmen, government-procurement contracts in the United States for computer and data processing services are considerably larger than those in Europe, thus encouraging firms to compete for domestic contracts rather than for foreign ones.

[100] All figures estimated by the staff of the U.S. International Trade Commission.

Views of Interested Parties

No formal submissions were received.

Radio and Television Communications Equipment, Including Telemetering Equipment, Excluding Home-Type Radio and Television Equipment (Both Airborne and Nonairborne)

Possible Effects

U.S. exports to the EC

The adoption of this directive is not likely to cause a significant increase in U.S. exports. U.S. exports of radio and television communications equipment[101] are less than 10 percent of domestic shipments. However, the EC is an important market for U.S. firms.

The EC is the largest export market for radio and television communications equipment and accounted for about 23 percent of total U.S. exports in 1988, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	109
Japan	36
Canada	62
World	474

U.S. exports of radio and television communications equipment to the EC increased from $64 million to $109 million in 1988, an increase of 68 percent. Total U.S. exports increased by 35 percent during the same period. Major U.S. suppliers include AT&T, General Electric, GTE, Harris Corp., E.F. Johnson, and Motorola.

The United Kingdom, the largest market in the EC for U.S. exports of radio and television communications equipment, purchased between $26 million and $32 million worth annually from 1984 through 1988. West Germany and France have both more than doubled their imports of this equipment from the United States from 1984 to 1988, to $14 million and $24 million respectively. These three countries accounted for

[101] Radio and television communications equipment includes transmitters, receivers, transceivers, television cameras, cellular digital land-based communications systems, and pagers.

over 60 percent of U.S. exports of radio and television communications equipment to the EC in 1988. Major suppliers from the EC include Alcatel, Phillips, Siemens, and Thomson.

The United States and Japan are the largest suppliers of this equipment to the EC, each providing 11 percent of EC imports in 1987. In 1984, the United States provided 17 percent of EC imports, and Japan provided less than 10 percent. Whereas EC imports increased by 89 percent during this period, U.S. exports to the EC increased by 21 percent, and Japanese exports to the EC increased by 117 percent. Major Japanese suppliers include Fujitsu, Matsushita, Mitsubishi, NEC, OKI, Sony, and Toshiba.

EC member countries are most likely to continue to buy from national sources, then from other EC member countries. EC member countries probably will purchase radio and television communications equipment from non-EC member countries only when the products are not available from an EC supplier. Moreover, since competition is being introduced to European Post, Telephone, and Telegraph Administrations in services such as paging and mobile communications, procurement of such equipment may be removed from the scope of the EC's proposed rules.

EC 1992 standards policy has a bearing on future U.S. sales of such equipment. All of the cellular telephone systems currently in the EC are largely incompatible. U.S. manufacturers currently supply some of the EC systems. However, frequencies assigned to the new cellular system are not exactly compatible with existing cellular telephone systems in the EC, and it is likely that all competitors in the EC market will start from the same point.

Diversion of trade to the U.S. market

EC member countries currently buy little radio and television communications equipment from outside the EC. It is unlikely that a major third-country supplier will be hurt by this directive and therefore will divert shipments to the United States. As noted previously, however, Japan has a growing stake in the EC market and could be harmed if the directive's proposed value-added requirement were used to discriminate against Japanese firms.

U.S. investment and operating conditions in the EC

The directive will not adversely affect existing U.S. investment in the EC. The directive would encourage future U.S. investment in the EC, most likely in the form of joint ventures with existing EC producers, in order to increase access to EC government markets. The problem will be to ensure that the products produced by either subsidiaries or joint ventures contain at least 50 percent local content.

U.S. Industry Response

At present, the U.S. industry is assessing the impact of the directive.

Views of Interested Parties

No formal submissions were received.

Optical Fiber and Related Equipment

Possible Effects

U.S. exports to the EC

Initially, the proposed directives will be trade liberalizing only for EC firms and may not create substantial opportunities for non-EC suppliers of optical fiber and related equipment. However, the proposed directive leaves open the possibility for an EC contracting entity to choose a non-EC offer on the basis of a sound technical reason in relation to the operation and maintenance of existing material. Furthermore, a U.S.-owned manufacturing operation, joint-venture partner, or licensor may benefit from the proposed directive in cases wherein at least one-half of the value of the goods offered to the contracting entity represents goods produced inside the EC.

The public sector is extremely important relative to the total EC telecommunications market for optical fiber, cable, and related equipment. In the past several years, the largest U.S. independent manufacturer of lasers used in fiber optic systems achieved almost two-thirds of its revenues by sales to EC firms that develop fiber optic systems. Overall world market share by U.S. manufacturers of optical fiber, cable, and fiber optic transmission systems and components is about 25 percent. Overall market share by U.S. companies for optical fiber in the EC in 1988 was about 35 percent, including U.S. exports, joint-venture revenues, and licensing fees. EC market share for U.S.-producers of lasers and other components of fiber optic transmission systems was about 25 percent. Most of this market share is achieved through exports.

U.S. exports of optical fiber and cable more than doubled during 1985-88, from $34 million to $73 million. Exports to the EC in 1988 amounted to $22 million, or 30 percent of the total exports of such goods, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	22
Japan	10
Canada	11
World	73

In all but a few instances, each EC country has a similar institutional framework in which the telecommunications networks and services have been the responsibility of a public monopoly, PTT, whereas the equipment used by the networks has been supplied by private enterprise. For both economic and political reasons, the PTTs generally have developed procurement policies that favor a limited number of suppliers in each country and these suppliers share the major segment of the market among them. Barriers to entry in the EC fiber optic market include the working relationship between British Telecom and its fiber optic equipment suppliers GEC and Plessey, the DGT and Alcatel in France, and the Deutsche Bundespost and Siemens in West Germany. EC officials estimate that 70 to 90 percent of contracts awarded by PTT administrators have gone to national producers.

There are no third-country markets that are significantly open with respect to telecommunications equipment. Generally, products from foreign firms have been accepted in important markets like Canada and the EC only because they possessed critical technology. This has helped U.S. and Japanese firms that possess advanced fiber optic technology to acquire market share.

Diversion of trade to the U.S. market

The EC is an important market to U.S. producers, accounting for a significant portion of U.S. exports of optical fiber and optoelectronic transmission components and systems. If the EC countries were to lower trade barriers against each other but maintain the barriers against the rest of the world, outside producers might be adversely affected. Production for the EC market might shift from producers in one of these non-EC countries, to major EC producers like Alcatel, Siemens, and Phillips. Diversion of trade could occur and could lead with an increase in U.S. imports from Japan, which is a major competitor with the United States in important third-country markets. A protected EC market could also serve to strengthen French, British, and West German companies, making them more competitive in third-country markets that the U.S. firms compete in.

U.S. imports of optical fiber and cable declined from $97 million in 1985 to $33 million in 1988. Imports from EC countries amounted to $5 million in 1988, or 17 percent of total imports. Almost all of the imports consisted of optical-fiber cable since the licensing agreements Corning has established with EC companies prohibit the firms from selling optical fiber in the U.S. market. The reason for such a small number of imports in 1988 was a rapid decline in the U.S. market as major long distance fiber optic networks were completed in the United States. Industry experts believe that the market will remain sluggish for several years until fiber optics is used more intensively in local area networks and subscriber links to the home. U.S. production of optical fiber and cable in 1988 was about $657 million.

U.S. investment and operating conditions in the EC

U.S. companies have had some success in penetrating the protected EC markets, largely because of their technology and patents. Nevertheless, much of the penetration of the optical-fiber market is in the form of joint ventures and licensing agreements with preferred PTT suppliers in each country. Corning Glassworks and AT&T Network Systems, the major U.S. producers of optical fiber, are the major exporters to the EC and also have a significant amount of investment in the EC. Corning has a joint venture with the British company BICC to produce optical fiber. Corning has also established a joint venture with the West German firm Siemens to produce optical fiber in West Germany. By 1989, the West German venture will rival the British venture as the largest EC manufacturer of optical fiber. In addition, Corning Glassworks, which holds major patents on its telecommunications-grade optical fiber, has licensed firms in France, Italy, the Netherlands, and Spain to manufacture optical fiber for sale in specified markets other than the United States. AT&T, which is cross-licensed by Corning to manufacture optical fiber, has established a joint venture with NKT in Denmark.

Smaller U.S. manufacturers of optical fiber and optoelectronic devices and transmission systems would be harmed the most from the proposed directive since, compared to larger U.S. companies, such firms have little investment in EC manufacturing facilities or joint-venture or licensing arrangements that would permit them to participate in the EC market. For companies like AT&T and Corning, that have significant investment in EC operations, imports of U.S.-made components and systems by their EC manufacturing facilities would be likely to decline and manufacturing and licensing activity in the EC would increase.

U.S. Industry Response

U.S. industry officials have indicated that they intend to seek equal access for U.S. firms in EC procurement activities on the basis that the U.S. telecommunications market is already open to EC companies.

Views of Interested Parties

No formal submissions were received.

Telecommunications Equipment

Possible Effects

U.S. Exports to the EC

The EC remains the largest export market for the United States in telephone and telegraph equipment, followed by Canada and Japan. The EC's share of the total value of U.S. exports increased steadily from $818 million in 1984 to $1.3 billion in 1988, or by 64 percent. U.S. suppliers of telecommunications switching and transmission equipment include AT&T, Northern Telecom, and ITT. The large increase in exports to the EC, particularly in 1988, was due, in part, to the weaker dollar, which has enhanced the price competitiveness of U.S. products. Absent worsening of the market environment, the potential exists for U.S. exports to the EC to continue to increase during the next 5 years.

Several aspects of the 1992 program could disadvantage U.S. suppliers, however. As part of the program, the EC is expected to unify telephone and telegraph equipment standards. If there is not full transparency in the establishment of standards, European standards could be established that could adversely affect U.S. exports to the EC and create benefits for EC suppliers serving a hitherto fragmented EC market. Siemens, Alcatel, Ericsson, GEC-Plessey, and Thompson are the leading EC suppliers, and these firms have traditionally benefited from buy-national policies of the 12 major PTTs in Europe. Since the directives require the use of harmonized EC standards in procurement documentation, adoption of discriminatory standards could effectively preclude U.S. participation in the EC public sector market, by far the most significant potential market for U.S. makers of switching and transmission gear.

In addition, the method of how domestic content will be calculated has yet to be clearly defined. This method could be a mechanism used to prevent EC subsidiaries and affiliates of third-country suppliers from being awarded telecommunications procurement contracts. Under the directive, purchasing authorities may reject an offer when more than half the value of that offer represents products manufactured or services performed outside the EC. Valuation of software for origin purposes is likely to be a key issue, since network-related switching equipment relies heavily on sophisticated software for its operation. Most contracts for network-related equipment are presently "bundled," meaning that services and equipment are purchased under one tender. Breaking up such contracts could also affect origin determinations, and thus the ability of U.S. firms to sell in the EC market.

The EC is the largest export market for U.S. telephone and telegraph apparatus and accounted for about 21 percent of total U.S. exports in 1988, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	1,345
Japan	583
Canada	751
World	6,517

Diversion of trade to the U.S. market

Directive 88/378 could also be trade discriminatory against Japan and thus could result in a diversion of trade to the United States. Japan is a major exporter of telephone and telegraph equipment to international markets, with the EC being its second-largest market after the United States. NEC and Fujitsu are the leading Japanese suppliers. Japan accounts for about 25 percent of EC imports. According to industry sources, domestic-content requirements would most adversely affect third-country suppliers such as Japan. The prevailing sense in industry circles is that purchasing authorities, particularly those under direct government control, will come under strong pressure to apply such requirements.

U.S. imports of Japanese telephone and telegraph equipment increased steadily during 1984-88, rising from $8.7 billion in 1984 to $9.8 billion in 1988, or by 12 percent. Japan's share of the total value of imports decreased from 56 percent in 1984 to 46 percent in 1988. The extent of any diversion of Japan's EC-bound trade to the United States would most likely be modest.

The U.S. industry dominates its home market for telephone and telegraph equipment. U.S. producer shipments rose at an annual rate of 3 percent during 1984-88, increasing from $14.2 billion in 1984 to $16.3 billion in 1988. However, a number of producers are producing offshore to remain cost competitive in the marketplace.

Total SITC imports of telephone and telegraph equipment during 1984-88 rose to a high of $21 billion. Aside from Japan, the only significant suppliers were Canada and the United Kingdom, both supplying approximately 3 percent of imports in 1988.

U.S. investment and operating conditions in the EC

The implications of directive 88/378 for U.S. investment and operating conditions in the EC are both positive and negative. As noted previously, it appears that U.S. suppliers are increasing their investment and joint-venture

activity in the EC. It appears that these investments are driven both by the perception of increased opportunity, marketing necessities (i.e., the need for ongoing engineering support), and fear of the unknown.[102]

U.S. original-equipment manufacturers of this equipment will be fundamentally affected by decisions made in the EC and by procuring entities regarding standards and technical specifications for network switching and transmission equipment.

U.S. Industry Response

The U.S. industry supports the efforts that the EC is taking to open procurement practices in its telecommunications sector. According to industry sources, liberalizing these procedures should lead to increased competition among telecommunications suppliers, which in turn will exert downward pressures on prices as domestic suppliers respond to the challenge of competitors. Greater efficiency could also be achieved because national purchasing authorities might award contracts to the least expensive and most efficient suppliers rather than purchase automatically from traditional national suppliers. However, the U.S. industry believes certain provisions of the directive must be clarified so as not to militate against participation by third-country suppliers—specifically, reciprocity, standards, bidding procedures, EC content, valuation of software, and the scope of applicability.

In testimony submitted to the House Foreign Affairs Subcommittee on April 17, 1989, regarding government procurement within the EC, AT&T expressed its support for the efforts undertaken by the EC to create a unified European market for telecommunications equipment and services by 1992. AT&T generally supports the EC Commission's efforts to open to competition the procurement practices of member states in the telecommunications sector to the extent the directives reflect the intent of creating mutual marketing opportunities as stated in the Omnibus Trade Act. AT&T strongly favors broadening the scope of the proposed directive to ensure that the range of public procurement activities in the EC telecommunications market will be open to competition.

Views of Interested Parties

No formal submissions were received.

[102] See, for example, testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers, Apr. 11, 1989, transcript, pp. 92 and 100 to 103.

CHAPTER 5
FINANCIAL SECTOR

CONTENTS

CONTENTS—*Continued*

Chapter 5

Financial Sector

Introduction

The European Community expects that if and when the 1992 legislative package is adopted and implemented, financial products and services will circulate freely. The approximately 30 directives that apply to the financial sector are intended to remove legal barriers that effectively prevent financial services firms from freely establishing themselves in another member state or from freely selling their services in another member state on a cross-border basis.

The 1992 program for financial services has raised interest and concern in the United States. U.S. firms are aware that EC capital markets and financial firms are likely to become relatively more competitive and efficient. Liberalized and open financial and capital markets in the European Community may create potential business opportunities for U.S. financial services firms that are operating in the EC or that may wish to consider operating there in the future. U.S. firms are unsure, however, of how the European Community and the individual member states will implement the 1992 program and conduct their commercial policy and external relations with third countries.

Reciprocity provisions have been incorporated in the financial services directives, and U.S. firms are concerned about whether the adoption and implementation of the single-market legislation may, either directly or indirectly, have the effect of restricting existing or future business activity. Whether and to what extent U.S. firms will be able to choose to seek to take advantage of the potential business opportunities on an equal and nondiscriminatory basis depends on many unanswered questions.

Overall Background

New computer and telecommunication technologies, as well as the trend toward deregulation, have contributed to the globalization of world financial markets. The 1992 program for the financial services sector is in large part a response to this process. The frequent introduction of new and hybrid financial instruments, along with the structural and institutional changes occurring in the investment banking and commercial banking sectors, has highlighted the need for greater cooperation between various regulatory authorities within the same national market and between regulatory authorities in different countries. The 1992 program responds to these developments and is intended to accelerate the trend toward relying on the efficiencies of global market forces in the European Community.

In general, the EC financial market may currently be characterized as relatively fragmented. Although the Treaty of Rome set forth the free movement of services and capital as two of its principal objectives,[1] regulatory barriers to the full freedom of capital movements, to cross-border trade in services, and to the establishment or acquisition of financial service firms have effectively operated to restrict the full financial integration of the EC market. Financial firms desiring to operate in each of the 12 member states must generally seek 12 separate authorizations and comply with 12 different regulatory regimes. The Cecchini Report on the "Costs of Non-Europe"[2] estimated that "[s]ubstantial economic gains may be expected from real integration of European financial services markets" on "[a]n order of magnitude of Ecu 22 billion."[3]

The White Paper states the EC Commission's view that, "the establishment of a common market in services . . . [is] one of the main preconditions for a return to economic prosperity. Trade in services is as important for an economy as trade in goods."[4] The European Community's objective is to seek financial integration and at least a degree of monetary integration.[5] The financial services directives, in conjunction with the capital movements directives, are intended to

[1] Art. 3(c) of the Treaty of Rome provides that the activities of the European Community shall include the abolition of obstacles to freedom of movement for services and capital. Arts. 52 and 59, respectively, provide that any restriction on the freedom of establishment and the freedom to provide services shall be progressively abolished. Arts. 58 and 66 provide that "[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community" shall be entitled to these freedoms. Art. 67 provides for the progressive abolition of restrictions to the movement of capital. The Single European Act (SEA) introduced qualified majority voting and reaffirmed that the free movement of services and capital must be ensured (see art. 13 of the SEA).

[2] See P. Cecchini, *The European Challenge 1992: The Benefits of a Single Market* (EC Commission, [1988]). This study examined the costs of the major trade barriers within the European Community for certain service and manufacturing sectors. It also summarizes the regulatory regimes and regulatory barriers for financial services in eight of the member states. The results of the study for the financial services sector are set forth in vol. 9 of the basic findings.

[3] See Cecchini Report, p. 37.

[4] See par. 95 of the White Paper on Completing the Internal Market (EC Commission, [1985]).

[5] See "Progress Report on the European Monetary System and the Liberalization of Capital Markets," COM(87) 650 of Dec. 17, 1987. The report states that "[c]apital liberalization, together with financial innovation, create the potential for larger destabilizing capital movements." The report provides further that "capital liberalization will increase the need for policy convergence within the EMS." See also *Report on Economic and Monetary Union in the European Community* (Committee for the Study of Economic and Monetary Union, [April 1989])(Delors Committee Report). The Delors Committee Report sets out a three stage process that could progressively lead to economic and monetary union in the EC.

have three broad effects: (1) to liberalize the financial services sectors; (2) to benefit the individuals and firms that consume such services, as well as to create opportunities for the suppliers of such sectors (e.g., computer-equipment manufacturers, telecommunications service providers, and other information-services suppliers); and (3) to increase the discipline of market forces on the monetary and fiscal policy of member states.

In order to achieve these objectives, the European Community set out to harmonize essential standards regarding authorization, supervision, and prudential rules[6] and to provide for the mutual recognition of home-member-state control on the basis of those harmonized rules. In particular, the European Community set out to coordinate essential requirements regarding such matters as capital adequacy, reporting and recordkeeping, information disclosure, compensation schemes for reorganizations and winding-up, and accounting requirements. This coordination was intended to provide for transparency, comparability, and equality of competitive opportunity; to protect consumers of financial services; and to minimize competitive rulemaking.

Although most of the necessary directives in this area, as outlined in the White Paper, have been proposed and some have been adopted, a host of definitional and interpretive uncertainties remain. As more final directives are adopted and as national governments begin to implement the directives, the net effect of the financial services directives in the European Community, in individual member states, and in the rest of the world should become clearer.

Capital Movements

The 1992 program includes three capital-movement directives. One directive provides for the free movement of shares of mutual funds. The second directive applies to long-term commercial credits and certain securities activities. The final directive provides for the full liberalization of all capital movements by July 1, 1990.

Background

The free movement of capital is set forth in the Treaty of Rome as one of the principal activities of the European Community (art. 3(c)). The treaty provides that the progressive abolition of restrictions on the movement of capital is to be implemented by means of Council directives (arts. 67 to 73). Indeed, the EC Commission's White Paper on the internal market recognizes that the free movement of capital is one of the essential preconditions to the creation of the single market in the European Community and that the use of the treaty's safeguard clauses (arts. 73 and 108 to 109) should be strictly limited. Moreover, the Treaty of Rome, as amended by the Single European Act (SEA), provides that the internal market shall comprise an area without internal frontiers, in which the free movement of capital is ensured.[7]

The First Capital Movement Directive of 1960,[8] as amended,[9] noted that the abolition of restrictions on capital movements would facilitate the movement of goods, persons, and services and would contribute to the establishment of a common market. The First Capital Movement Directive sets forth a list of capital movements, as well as explanatory notes, in annex II. In general, a capital movement is a cross-border transfer of capital.[10]

The First Capital Movement Directive categorizes capital movements into four lists, which are set forth in annex I. Article 1 of the directive provides that the capital movements in list A are deregulated unconditionally and that member states are obliged to ensure that such movements are made at current exchange rates. Article 2 deregulates unconditionally the capital movements in list B, but member states are simply obliged to "endeavor" to ensure that such movements are made at rates that do not differ appreciably from current rates. Movements in list C were conditionally deregulated (art. 3), and member states had no obligations regarding movements in list D.

Anticipated Changes

The 1992 program set out to provide for greater liberalization of capital movements and to strictly limit the use of safeguard clauses.[11]

[6] Prudential rules govern matters relating to the financial security, stability, and solvency of firms. In the banking sector, for example, the EC set out to coordinate rules of prudential supervision regarding own funds, solvency ratios, large exposures, and deposit guarantee schemes.

[7] For a general description of the EC Commission's program to liberalize capital movements, see *European Economy No. 36: Creation of a European Financial Area Liberalization of Capital Movements and Financial Integration in the Community* (EC Commission, [May 1988]).

[8] First Council Directive of May 11, 1960, *Official Journal of the European Communities (O.J.)* No. 43/921 (July 12, 1960).

[9] Second Council Directive 63/21/EEC, *O.J.* No. 9/62 (Jan. 22, 1963).

[10] The annex II nomenclature sets forth a definitional framework of capital movements, which includes, for example, direct investments in undertakings or real estate, transactions in securities, short and medium term credits related to the sale of goods or services, other loans and credits, the opening of current or deposit accounts, and transfers related to the performance of insurance contracts, as well as other capital movements.

[11] The Treaty of Rome provides in arts. 73 and 108 to 109 that, under certain conditions and procedures, a member state may take protective measures, including maintaining or reintroducing restrictions on capital movements, to safeguard its financial system if the member state has balance of payments problems or if the functioning of the member state's capital market is disturbed.

Council directive 85/583/EEC[12] removed the restriction on the free movement of mutual fund shares covered by the Mutual Fund Coordination Directive.[13] Council directive 86/566/EEC[14] extends the unconditional liberalization obligations set forth in article 1 of the first directive to (1) long-term commercial credits; (2) the purchase of securities not traded on an exchange; and (3) the admission of securities to the capital market.

The full liberalization of capital movements

Council directive 88/361/EEC[15] extends the unconditional liberalization obligation to all capital movements. This extension applies principally to (1) investments in short-term securities (i.e., issued for a period of under 2 years); (2) current- and deposit-account operations;[16] and, (3) financial loans and credits. The subject directive repeals the First Capital Movement Directive as of July 1, 1990, and effectively does away with the categorization of capital movements in lists A to C, which are subject to varying degrees of liberalization (art. 9). The subject directive also repeals and replaces Council directive 72/156/EEC,[17] which regulated international capital flows and neutralized their undesirable effect on domestic liquidity (art. 9). Lastly, the directive incorporates a list of capital movements and explanatory notes in annex I.

Article 1 of the directive provides that member states shall abolish restrictions on all capital movements between member-state residents and that such transfers shall be at current exchange rates. This liberalization should enable residents of a member state to operate in the financial system of another member state, in order to engage in investment, lending, or borrowing operations. Moreover, the EC Commission stated that the liberalization applies not only to transfers of capital, but also to the underlying transaction being concluded or performed.[18] In other words, the EC Commission is seeking to remove restrictions that would prevent the completion of a transaction involving a capital movement.

Four types of limited exceptions to unconditional deregulation are provided in the directive. First, member states may take measures to regulate bank liquidity that have a specific impact on capital transactions carried out by credit institutions with nonresidents, provided that such measures are necessary for the purposes of domestic monetary regulation and that the member state provides notice thereof (art. 2). Second, a member state may take limited and temporary protective measures "where short-term capital movements of exceptional magnitude impose severe strain on foreign-exchange markets and lead to serious disturbances in the conduct of a member state's monetary and exchange rate policies" (art. 3). Third, a member state may take requisite measures to prevent the infringement of their laws; accordingly, a member state could track capital movements for statistical or tax-enforcement purposes, as long as capital movements are not impeded (art. 4). Lastly, numerous transitional provisions are provided for Spain, Portugal, Greece, Ireland, Belgium, and Luxembourg.

International capital movements

Article 70(1) of the Treaty of Rome provides that the European Community shall seek the highest possible degree of liberalization with third countries. The subject directive provides that member states shall seek the same unconditional liberalization of international capital flows that applies to operations between residents of other member states (art. 7). However, article 7 of the directive additionally provides that—

> "The provisions of the preceding subparagraph shall not prejudice the application to third countries of domestic rules or Community law, particularly any reciprocal conditions, concerning operations involving establishment, the provisions of financial services and the admission of securities to capital markets."

Therefore, the European Community as a whole or individual member states may choose to negotiate with third countries regarding international capital flows, though it should be noted that some member states have already liberalized all capital movements.[19] Article 7

[12] *O.J.* No. L 372/39 (Dec. 31, 1985). This directive becomes effective on Oct. 1, 1989.
[13] Council directive 85/611/EEC, *O.J.* No. L 375/3 (Dec. 31, 1985). This directive will become effective on Oct. 1, 1989.
[14] *O.J.* No. L 332/22 (Nov. 26, 1986). This directive became effective on Feb. 28, 1987. See *Program for the Liberalization of Capital Movements in the Community*, COM(86) 292 of May 23, 1986.
[15] *O.J.* No. L 178/5 (July 8, 1988). See Creation of a European Financial Area, COM(87) 550 of Nov. 4, 1987.
[16] The European Community is considering the coordination of withholding taxes on interest income as well as the reporting obligations of banks in this regard. See *Tax Measures to be Adopted by the Community in Connection with the Liberalization of Capital Movements*, COM(89) 60 final/3 of May 12, 1989.
[17] *O.J.* No. L 91/13 (Apr. 18, 1972).
[18] See "Explanatory Memorandum," COM(87) 550 of Nov. 4, 1987.
[19] U.S. International Trade Commission (USITC) staff held discussions regarding issues raised by the prospect of capital movement liberalization with EC Commission staff on April 20, 1989. The following member states have fully liberalized capital movements: West Germany, the United Kingdom, the Netherlands, and Denmark. Belgium and Luxembourg have yet to eliminate their dual exchange rate mechanism. France has fully liberalized with the exception of individual accounts in foreign currency held abroad. Although France has committed itself to full liberalization by July 1, 1990, it has sought to coordinate withholding taxes on interest income in order to minimize tax motivated capital flight and tax evasion.

additionally provides that member states may consult on measures to be taken when large-scale, short-term capital movements seriously disturb the monetary or financial situation of the European Community, or a number of member states.

Possible Effects

U.S. exports to the EC

The capital movements directives have as their goal the elimination of all remaining restrictions on the movement of capital between residents in the EC and will lift most of the remaining controls on capital movements within the EC. The directives are regarded by U.S.-industry contacts as essential steps towards free and integrated capital markets within the EC and have the potential to be trade liberalizing for U.S. financial services firms (banks, securities firms, and mutual funds) with branches or subsidiaries in the EC. These firms could benefit from their role as financial intermediaries to the extent that these directives encourage the growth of larger, more diverse EC capital markets. Industry contacts, however, emphasize that these directives would only benefit those firms that seize the opportunities promised by the newer, more competitive environment.

Although article 7 of Council directive 88/361 contains a reciprocity provision that could be applied to third countries, conversations with officials at U.S. financial institutions in the EC reveal little concern over application of this provision to U.S. firms since capital movements within U.S. capital markets are generally unrestricted.

Diversion of trade to the U.S. market

No diversion of trade to the U.S. market is likely because the subject directives are likely to expand trading opportunities for non-EC financial services institutions.

U.S. investment and operating conditions in the EC

The effect of the complete liberalization of capital movements is uncertain because so many variables (e.g., exchange-rate fluctuations, interest-rate fluctuations and differentials, tax-rate differentials) influence and are influenced by free capital movements. Free capital movements should increase the discipline of market forces on the monetary and fiscal policies of the member states. Whether and how to coordinate withholding taxes on interest income within the European Community has become a controversial issue that remains to be settled.

The EC expects that the full liberalization of capital movements, together with the liberalization of financial services, should promote the competitive and efficient allocation of capital in the European Community. Firms will be able to raise funds throughout the European Community. Although large firms may already raise funds globally, small- and medium-sized firms should have relatively increased access to competitive capital markets throughout the European Community. Individuals should have increased opportunities to place their savings where it brings the highest returns (e.g., savings accounts, mutual funds, money market instruments).

In addition, to the extent that the capital movements directives expand capital markets within the EC by permitting capital to cross borders freely, these directives should expand opportunities for financial intermediaries, including U.S. banks, securities firms, and institutional investors (e.g., mutual funds, pension funds). As such, these directives could be beneficial to those firms wishing to compete in what should be a more competitive environment. Finally, U.S. multinational corporations in the United States should benefit from the freedom of capital movement as borrowers will have access to additional and, in theory, less expensive sources of financing.

U.S. Industry Response

Interviews with officials at leading financial services firms indicate that the capital movements directives may encourage U.S. firms not presently operating in the EC to establish a presence in the EC in order to take advantage of the increased trading opportunities that will be made available by the freer movement of capital throughout the EC.

Views of Interested Parties

Interviews with officials at U.S. financial services firms in the EC indicate general support for these directives. The National Association of Manufacturers (NAM) has noted that, following the full liberalization of capital movements, the European Community will be discussing the possibility of and need for greater monetary policy coordination. The NAM expects that developments in this area "will have a major impact on U.S. international industrial competitiveness" because possible currency realignments within the EC "will affect both dollar-rate production costs within the EC and the competitive prices of German and other EC manufactured goods on world markets."[20]

Banking Services

The 1992 program includes 10 banking directives.[21] The most important is the Second

[20] See S. Cooney, *EC 92 and U.S. Industry* (NAM, [Feb. 1989]).

[21] For a brief description of the EC banking industry, see ch. 29 of *Panorama of EC Industry 1989*, which is available from the EC's Office of Official Publications.

Banking Directive, which introduces the single banking license. The Own Funds and Solvency Ratio Directives relate to the capital adequacy of banks and must be implemented simultaneously with the Second Banking Directive. Other ancillary directives deal with the disclosure obligations of branches, accounting requirements, compensation schemes for the reorganization and winding-up of a bank, and mortgage credit. Three recommendations deal with deposit insurance, large exposures, and electronic-payment cards.

Background

Articles 52 and 59 of the Treaty of Rome prohibit any restrictive treatment with respect to the freedom of establishment and the freedom to supply services. The First Banking Directive[22] coordinated certain rules regarding the authorization and supervision of banks as a first step towards the effective implementation of the freedom of establishment. The 1992 banking program set out to facilitate the effective freedom of establishment and the freedom of services.

Anticipated Changes

The Second Banking Directive

The proposed Second Banking Directive,[23] which would introduce a single banking license, is the centerpiece of 1992 banking legislation and is deemed to be "essential for achieving the internal market."[24] The directive would harmonize certain, essential prudential rules[25] and would provide for the mutual recognition of such rules, as well as home-member-state control by the competent authority of the member state where the credit institution[26] is authorized.

The Second Banking Directive would provide that a credit institution that is authorized in a member state (i.e., home member state) to carry out certain activities[27] may carry out those same activities in another member state (i.e., host member state),[28] either through branching or through the cross-border provision of services, without having to obtain a separate authorization in the host member state (art. 16(1)). The list of liberalized activities includes commercial banking and investment banking activities. A bank with a single license could undertake traditional banking activities, as well as certain securities activities.

The directive introduces both product and geographic liberalization. If a U.S. bank establishes a subsidiary in an EC member state and the subsidiary is authorized under the directive, then the subsidiary should benefit from the single license. In addition, the benefits of the single banking license extend to enumerated activities undertaken by financial institutions[29] that are subsidiaries of credit institutions, if certain strict conditions are met (art. 16(2)). This latter provision would allow a credit institution to own a subsidiary financial institution which, for example, engaged in securities-related activities.

The proposal is likely to contribute to the freedom of establishment and the freedom to provide cross-border financial services for credit institutions. However, the extent to which U.S. firms will be able to participate in the creation of the internal banking market in the European

[22] First Council Directive 77/780/EEC, *O.J.* No. L 322/30 (Dec. 17, 1977).

[23] The amended proposal was COM(89) 190 final of May 29, 1989. The original proposal was COM(87) 715, *O.J.* No. C 84/1 (Mar. 31, 1988). Although a final common position on the amended EC Commission proposal for a Second Banking Directive was not reached at their meeting on June 19, the EC Council was reportedly near to reaching a common position in principle.

[24] See recital 1 of the Second Banking Directive.

[25] For example, art. 3 provides for minimum initial capital, art. 8 provides for minimum reserve requirements, and art. 10 sets forth limitations on a bank's ability to hold qualified participations in nonfinancial institutions.

[26] The differences between commercial banks, investment banks, investment firms, and other nonbank financial institutions are difficult to state with any clarity. Therefore, the EC determined to apply the Second Banking Directive to "credit institutions," which are defined as "an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account." See art. 1 of the First Banking Directive.

[27] The annex to the amended proposal lists the activities that are to be covered by the single banking license, which include deposit taking and other forms of borrowing; lending (including consumer credit, mortgage lending, factoring, invoice discounting, and trade finance); financial leasing; money transmission services; issuing and administering means of payment (i.e., credit cards, traveler's checks, and banker's drafts); guarantees and commitments; trading for the institution's own account or for the account of customers in foreign exchange; money brokering; credit reference services; and safe custody services. The annex list also includes investment activities (trading for the institution's own account or for the account of customers) relating to certain instruments. The investment activities include brokerage, dealing as principal, market making, portfolio management, arranging or offering underwriting services, professional investment advice, and safekeeping and administration. The enumerated instruments include transferable securities, money market instruments, financial futures and options, and exchange and interest rate instruments. In seeking a common position on the amended EC Commission proposal, the EC Council reportedly added the provision of financial advice relating to mergers and acquisitions and corporate finance to the list of liberalized activities.

[28] The "host member state" is the member state "where a credit institution has a branch or into which it supplies services." See art. 1 of the proposed Second Banking Directive.

[29] A "financial institution" is "an undertaking, not being a credit institution, whose principal activity is to grant credit facilities (including guarantees), to acquire participations or to make investments." Examples of "financial institutions" in the United States would be investment banks or finance companies. See art. 1 of Council directive 83/350/EEC, *O.J.* No. L 193/18 (July 18, 1983).

Community is uncertain because the proposal includes a "reciprocity" provision for third-country subsidiaries.[30]

Reciprocity and the treatment of third-country banks

The original EC Commission proposal of February 1988 would have applied a reciprocity test and an automatic suspension-and-review procedure to third-country banks, whereas the amended proposal of May 1989 removed the reciprocity test and introduced a more flexible procedure for dealing with third-country banks. The amended proposal provides that the EC would seek "comparable effective market access" and "comparable competitive opportunities" through negotiations with the third country concerned. Under the amended proposal, the EC would only suspend requests for banking licenses if EC banks do not receive genuine national treatment. At their meeting on June 19, the EC Council reportedly reached a common position in principle on the amended proposal for a Second Banking Directive.[31]

The original EC Commission proposal.—The original proposal for a Second Banking Directive,[32] which was issued in February 1988, contained a "reciprocity" provision[33] that raised significant concern both within the European Community and in third countries. The reciprocity provision would have made the entry of third-country banks into the single market dependent on whether all EC banks received "reciprocal treatment" (however defined) in the third country concerned.[34] U.S. firms were concerned that the EC Commission might have determined that the United States does not provide "reciprocal treatment" because the United States legally separates commercial and investment banking and legally restricts interstate banking, whereas the 1992 program allows universal and interstate banking.

European views.—Some member states and private sector interests supported the inclusion of a reciprocity provision as a so-called entry fee for the privilege of doing business in a large, unified market after 1992. They believed such a provision would reserve some of the potential benefits of the single market for EC-owned banks; would increase EC leverage in opening foreign markets; and would protect EC-owned banks, at least partially, from the potential, increased competition from non-EC institutions.

Other member states and private sector interests, however, did not support the inclusion of a reciprocity provision because it transferred additional bureaucratic and regulatory oversight to the EC institutions in Brussels, because it could lead to protectionism, thereby denying the European Community the benefit that was expected to come from deregulating the banking market and opening it to the market efficiencies of global competition, or because it might be implemented in a way that would undermine multilateral trade liberalization. Certain third countries, including the United States, expressed similar concerns about reciprocity.

U.S. concerns.—The U.S. Government and U.S. firms were concerned that the EC's reciprocity policy might be implemented and administered in a way that would restrict or prevent U.S. firms from competing on an equal and nondiscriminatory basis in the single market. They were concerned that the EC's reciprocity policy was ambiguous, that it created uncertainty, that it was inconsistent with the principle of national treatment, and that it might effectively undermine multilateral trade liberalization.[35]

[30] It should be noted that on Mar. 15, 1989, the European Parliament, in its report on the proposed Second Banking Directive, suggested amendments that would extend the coverage of the directive to apply to branches of third country credit institutions.

[31] See *European Report* (June 24, 1989).

[32] COM(88) 715, *O.J.* No. C 84/1 (Mar. 31, 1988).

[33] The original EC Commission proposal of February 1988 provided that, when a third country bank seeks an EC banking license from a member state, the competent authority of the member state concerned must inform the EC Commission and the other member states and automatically suspend its decision, pending the outcome of an administrative review procedure. The automatic suspension and review procedure applied when a third country firm requested banking authorization for a subsidiary or when a third country firm proposed the acquisition of an existing EC bank. Under art. 7 of the original proposal, the administrative procedure would have suspended the decision for 3 months while the EC Commission "examine[d] whether all credit institutions of the Community enjoy reciprocal treatment . . . in the third country in question." If the EC Commission found that reciprocity was not ensured, then the EC Commission could extend the suspension and "present suitable proposals to the Council with a view to achieving reciprocity with the third country in question."

[34] One of the basic difficulties, which raised concern in the EC, the United States, and other third countries, was that it was not at all clear what the EC Commission meant by "reciprocal treatment," nor what kind of third country treatment would satisfy this test. Reciprocity could be interpreted in many ways, and it could have different meanings and implications depending on the specific context. The most restrictive form of reciprocity is mirror image reciprocity, which could require identical treatment in the third country. A country that applied this interpretation might expect to receive better than national treatment in a third country. Other formulations of reciprocity include sectoral reciprocity, overall reciprocity (which is a standard that appears in the GATT), or reciprocal national treatment. For a general description of some of the various formulations of reciprocity, see, e.g., Harrison, Glennon J., *The European Community's 1992 Plan: An Overview of the Proposed 'Single Market'*, Congressional Research Service (The Library of Congress [Sept. 21, 1988]).

[35] During 1988 and early 1989, various statements were issued by the EC in an attempt to clarify the meaning of the provision and the EC's intention. However, until May 1989, the actual text of the proposal was not altered.

U.S. banking firms were principally concerned that they would be prevented from operating on an equal, competitive and nondiscriminatory basis in the single market because the EC Commission might have determined that the United States does not provide "reciprocal treatment." In addition, they were concerned that reciprocity may be applied to restrict U.S. subsidiaries that are already authorized and operating in the EC market,[36] and, moreover, that it may be applied when such subsidiaries undertake a corporate restructuring, or engage in new activities, or make an acquisition.[37] U.S. firms were also concerned that reciprocity might be applied retroactively. Lastly, U.S. firms were concerned that, even if the United States were found to be providing "reciprocal treatment," the suspension and review procedure was automatic, and it lasted for at least three months.

The amended EC Commission proposal.—In response to internal and external pressure, new reciprocity language was proposed by the EC Commission in April 1989. The new language was incorporated in the amended EC Commission proposal for a Second Banking Directive, which was issued on May 29, 1989.[38] Article 7 of the amended EC Commission proposal replaced the reciprocity provision in order to simplify and clarify the treatment of third-country banks. The phrase "reciprocal treatment" was deleted from the text of article 7, although the new provision was entitled "reciprocity."

The amended proposal replaces the automatic suspension-and-review procedure with a notification requirement. The amended proposal provides that the member states must inform the EC Commission of any "general difficulties" that EC banks have in engaging in banking activities in any third countries. Also, the member states must inform the EC Commission whenever any third-country bank "request[s] for authorization of a subsidiary" or "acquires [a] participation" in an EC bank. Under the amended proposal, therefore, a request for authorization, or even an actual acquisition, would not trigger an automatic suspension procedure.

In addition, the EC Commission is authorized to prepare a periodic report on the treatment of EC banks "regarding the establishment and carrying out of banking activities [in third countries], and the acquisition of participations" in third-country banks. The amended proposal adds a new requirement that a member state must inform the EC Commission of "the identity of the ultimate parent undertaking" when authorization is granted to a third-country subsidiary.

In addition to being notified and being authorized to prepare a report, if the EC Commission finds that a third country is not granting EC banks "effective market access and competitive opportunities comparable to those accorded by the Community to credit institutions of that third country" (however defined), then the EC Commission may submit "suitable proposals" for negotiations with the third country concerned. The proposals would be submitted to the EC Council "with a view to achieving such comparable access and competitive opportunities through negotiations." The amended proposal does not deal with sanctions in the event that negotiations fail.

Like the term "reciprocal treatment," the terms "comparable effective market access" and "comparable competitive opportunities" are subject to differing interpretations and may have different meanings in various circumstances. It is not clear from the text what meaning the EC Commission intends, nor is it clear what kind of third-country treatment would be found to be comparable.

In addition to proposing negotiations, if the EC Commission finds that EC banks "do not enjoy national treatment and the same competitive opportunities as domestic credit institutions in a third country and that the condition of effective market access has not been secured," then the EC Commission may direct the member states to "limit or suspend their decisions regarding requests for new authorizations and acquisitions" by banks from the third country concerned. In this situation, it is similarly not clear how the EC Commission intends to interpret this provision. The formulation of the three-part test seems to suggest that the third country in question must provide something more than just national treatment in order to avoid the suspension procedure.

The EC Commission has made clear that in applying this provision it will be looking to see that EC banking firms receive national treatment that really works in practice (i.e., de jure and de facto effective market access) and that "any country providing genuine national treatment to Community banks would be under no threat."[39] The amended proposal provides that any measures taken under article 7 will conform to the European Community's international

[36] It should be noted, however, that the explanatory memorandum that accompanied the proposed Investment Services Directive, which is modeled on the Second Banking Directive, provides that "*[a]s in the case of the banking Directive,* the reciprocity regime does not apply to existing investment businesses already established in the Community" (emphasis added). This statement gives one indication of the EC Commission's intention regarding the application of the reciprocity provision to existing and established investment firms and credit institutions. See "Explanatory Memorandum," COM(88) 778 of Dec. 16, 1988.

[37] It should be noted that art. 58 of the Treaty of Rome provides that "[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall . . . be treated in the same way as natural persons who are nationals of Member States." Under the treaty, therefore, existing subsidiaries of U.S. firms should be treated equally as EC firms.

[38] COM(89) 190 final of May 29, 1989.

[39] See "Explanatory Memorandum," COM(89) 190 final, May 29, 1989.

obligations and that the duration of such measures will not exceed 1 year, although the EC Commission may propose a renewal.

The EC Commission has stated that the "fresh proposal on reciprocity with non-Community countries . . . has calmed the fears awakened in the Community's trading partners."[40] Nevertheless, the text of the amended proposal does not clarify how subsidiaries that are already authorized and operating in the EC will be treated, nor does it clarify how the provision will be applied when such subsidiaries engage in new activities, undertake a corporate restructuring, or make an acquisition. In addition the text does not specify whether or not the provision will be applied retroactively.

The common position of the EC Council.—At their meeting on June 19, the EC Council reportedly reached a common position in principle on the amended proposal for the Second Banking Directive.[41] The EC Council reportedly largely accepted the EC Commission's amended proposal.[42] In addition, however, the common position in principle reportedly provides that the suspension procedure does not cover third-country subsidiaries that are already authorized and operating in the European Community.[43]

The discussion at the EC Council centered mainly on the procedure that would apply to reviewing requests for banking authorizations from third-country banks. In addition, the issue of whether the EC Commission or the EC Council should have final responsibility for reviewing third-country banking applications and examining third-country treatment of EC banks was discussed. In an apparent compromise on the issues regarding procedure and ultimate authority, the EC Council was reportedly given greater responsibility for reviewing third-country banking applications. Under the common position in principle, the EC Commission would report on third-country treatment, would make proposals to the EC Council for negotiations, and could suspend applications for up to 3 months, pending a final decision by the EC Council.

The regulatory regime under the Second Banking Directive

Home-country supervision.—The Second Banking Directive would supplement the authorization requirements set forth in article 3 of the First Banking Directive to require that the initial paid-up capital be at least 5 inform the competent authority of the identity of million ECU (art. 3).[44] In addition, applicants for banking authorization would be required to persons capable of exercising a significant influence[45] on the credit institution, so that such persons' suitability for the license may be appraised (art. 4). If the competent authority is not satisfied as to the suitability of such shareholders, then the authorization may not be granted.

The home member state must ensure that the credit institution has "sound administrative and accounting procedures and adequate internal control mechanisms" (art. 11). The home member state is responsible for supervising the activities of an authorized credit institution, including activities pursued in another member state either through a branch[46] or on a cross-border basis (art. 19).[47]

Host-country supervision.—The host member state "may no longer require . . . authorization for branches of credit institutions authorized in other Member States" (art. 5(1)) and, accordingly, such branches may no longer be required to be separately capitalized. Host-member-state control is expected to continue, however, for branches of third-country credit institutions and for activities that are not enumerated in the annex,[48] provided that the

[40] See *Fourth Progress Report of the Commission to the Council and the European Parliament* (June 1989).
[41] The official text of the common position had not been released to the public at the time that this report was printed.
[42] See *European Report* (June 24, 1989).
[43] See *European Report* (June 24, 1989).

[44] The European Community is discussing the adequacy of this figure, how it should apply to existing firms, whether exemptions should be granted, how it should apply to new firms, and whether it should apply on a continuing basis.
[45] The competent authorities must "have been informed of the identity of shareholders or members, whether direct or indirect, be they physical or legal persons, holding a qualified participation and of the amount of such participations" (art. 4). A "qualified participation" is "a holding, direct or indirect, in an undertaking which represents 10 percent or more of the capital or of the voting rights or which enables the exercise of a significant influence within the meaning of Article 33 of Council Directive 83/349/EEC," *O.J.* No. L 193/1 (July 18, 1983)(art. 1).
[46] If an authorized credit institution wants to establish a branch in another member state, it must notify the competent authority of the home member state regarding: the intended host member state, the type of business and the structure of the branch, the capital reserves and solvency ratio of the institution, the address of the branch, and the names of the persons responsible for the branch (art. 17). Within 3 months the competent authority of the home member state must convey such information to the competent authority of the host member state, which then has 3 months to prepare for appropriate (i.e., limited) supervision of the branch. The host member state may prohibit the branch from carrying out activities authorized in the home member state only if such activities are not listed in the annex and only if such prohibition is "in the interest of the public good" (art. 17(4)).
[47] If an authorized credit institution wants to carry out enumerated activities in another member state on a cross border basis, it must notify the home member state, which then has 1 month to notify the host member state (art. 18).
[48] It should be noted that technical amendments to the directive, including the addition of liberalized activities to the annex, would be able to be made by a committee of representatives of the member states (art. 20).

provisions of the host member state seek to protect the public good. In addition, the host member state would be responsible for supervising the liquidity of credit institutions, implementing monetary policy measures and, until further coordination, setting reserve requirements for operations in securities markets (art. 12).

The ancillary banking directives

The Second Banking Directive is one of a group of banking directives that make up the 1992 banking program. In conjunction with the capital movements directives, they should contribute to the creation of a common banking market. The ancillary directives seek to harmonize certain rules of prudential supervision throughout the European Community to facilitate mutual recognition of the single banking license. The objective is "to enhance [the] confidence of the public, strengthen and protect the banking system and reduce [the potential] competitive distortion" arising from the creation of a common banking market.[49] In order to ensure the equality of competitive opportunity within the European Community, the EC expects that the Second Banking Directive will become effective no sooner than at least some of the ancillary banking directives.

Capital adequacy.—The introduction of the single banking license depends on the adoption and implementation of at least two directives, which are central to the prudential supervision of credit institutions. The Own Funds Directive[50] sets forth common definitions and standards of "own funds" (i.e., capital adequacy).[51] The EC expects that common rules on bank capitalization will strengthen the banking sector and will reduce the potential for competitive distortion in the market.[52]

The proposed Solvency Ratio Directive[53] sets forth common standards of capital adequacy in relation to certain risk-adjusted assets and off-balance-sheet items. The ratio is "widely recognized as the most appropriate and flexible measure of solvency as it distinguishes between the degrees of risk associated with particular assets and off-balance sheet items."[54]

Accounting requirements.—In order to facilitate greater comparability and transparency, the Bank Accounting Coordination Directive[55] coordinates the requirements regarding annual and consolidated accounts of credit and financial institutions. The accounting directive should facilitate the administration of the own funds and the solvency ratio directives by the EC.

A related directive would generally extend the branch disclosure obligations of the proposed Eleventh Company Directive[56] to branches of credit and financial institutions.[57] Subject to "the condition of reciprocity" that is provided for in article 3(2), branches of credit and financial institutions that have their head office in a third country would generally be subject to the same disclosure obligations regarding accounting documents as branches of EC institutions if the legal form of the head office is "comparable" (art. 1(1)) and if the documents are "in conformity with or equivalent to" the documents

[49] See recital 4 of Commission recommendation 87/62/EEC, *O.J.* No. L 33/10 (Feb. 4, 1987).
[50] Council directive 89/299/EEC, *O.J.* No. L 124/16 (May 5, 1989). The directive will become effective no later than Jan. 1, 1993.
[51] This directive tracks the international capital standards developed by the Basle Committee of the Bank for International Settlements. For a summary of the work of the Basle Committee on capital adequacy, see J. Norton, "The Work of the Basle Supervisors Committee on Bank Capital Adequacy and the July 1988 Report on 'International Convergence of Capital Measurement and Capital Standards'," 23 The International Lawyer, p. 245 (Spring 1989).
[52] Capital reserves are considered "a key factor" of the internal banking market "since own funds serve to ensure the continuity of credit institutions and to protect savings." Moreover, the harmonization of bank capital requirements "will strengthen the supervision of credit institutions and contribute to further coordination in the banking sector, in particular the supervision of major risks and solvency ratios." See recital 1 of the Own Funds Directive.
[53] The amended proposal was COM(89) 239 final of May 26, 1989. The original proposal was COM(88) 194, *O.J.* No. C 135/4 (May 25, 1988). At their meeting on June 19, the EC Council reportedly reached a common position in principle on the Solvency Ratio Directive.
[54] See par. 3 of the explanatory memorandum in the proposal for a Council directive on a solvency ratio for credit institutions, COM(88) 194 final of Apr. 20, 1988. It should be noted that the Commission of the European Communities intends, after further study, to make appropriate proposals for further harmonization of prudential rules relating to interest and exchange rate risk and other market risks, including market risks arising out of open positions on securities markets.
[55] Council directive 86/635/EEC, *O.J.* No. L 372/1, (Dec. 31, 1986). This directive becomes effective on Dec. 31, 1990. This directive generally extends the coordination of the Fourth and Seventh Company Directives, which apply to the annual and consolidated accounts of companies, respectively, to credit and financial institutions, with certain exceptions as well as some additional rules that reflect the special characteristics of such institutions. See Fourth Council Directive 78/660/EEC, *O.J.* No. L 222/11 (Aug. 14, 1978) and Seventh Council Directive 83/349/EEC, *O.J.* No. L 193/1 (July 18, 1983). In conversations with USITC staff on Apr. 20, 1989, EC Commission representatives offered two examples of how banks are treated differently than companies. Banks are permitted to maintain "hidden reserves," and banks have only two options regarding profit and loss accounts, whereas companies have four options. It should be noted that a comparable proposed directive would generally extend the coordination of company accounting requirements to insurance firms. See COM(86) 768, *O.J.* No. C 131/1 (May 18, 1987).
[56] COM(88) 153, *O.J.* No. C 105/6 (Apr. 21, 1988).
[57] Branch Disclosure Directive 89/117/EEC, *O.J.* No. L 44/40 (Feb. 16, 1989).

required by the Bank Accounting Coordination Directive (art. 3(2)). Therefore, branches of third-country firms would only be treated favorably if branches of EC firms are treated favorably in the third country. By effectively precluding member states from requiring branches of EC institutions to publish annual accounts relating to their own activities, the proposal should facilitate the freedom of establishment in the banking sector.

Large exposures and deposit insurance.—EC Commission recommendations[58] on monitoring and controlling large exposures[59] and introducing harmonized deposit-guarantee schemes (i.e., deposit insurance)[60] have been adopted.

Mortgage credit.—The proposed Mortgage Credit Directive,[61] would facilitate the freedom of establishment and the freedom of services in the field of mortgage credit. The directive would provide that home member states must allow designated credit institutions[62] to engage in mortgage credit activities in any other member state with respect to real property in the European Community (art. 3). Host member states would have to allow designated credit institutions from another member state to undertake such activities in the host member state and must accord mutual recognition to the financial techniques permitted in the home member state (art. 4).

The directive would provide for host-member-state supervision of mortgage credit activities by branches and host-member-state law would apply (art. 8). On the other hand, the mutual recognition of home-country supervision would apply when mortgage credit activities are undertaken on a cross-border basis. However, the host member state would exercise oversight of the home-member-state supervision and host-member-state law that is justified on the grounds of the "general good" would apply (art. 10).[63]

Electronic payment.—The White Paper on the internal market noted that electronic banking and new electronic payment cards would tend to promote commercial activity (pars. 122 to 123). Accordingly, the EC Commission set out to encourage banks, traders, producers, and consumers to cooperate in designing payment cards (i.e., memory cards and online cards), machines and systems that accept the cards, network linkage, and user rules and fees that are compatible.

Commission recommendation 87/598/EEC[64] sets forth a nonbinding European Code of Conduct relating to electronic payment. The code defines electronic payment as "any payment transaction carried out by means of a card incorporating a magnetic strip or microcircuit at an electronic payment terminal (EPT) or point-of-sale (POS) terminal" (art. II(1)).

The code applies to the development of payment cards incorporating a magnetic strip and/or a microcircuit. The principal objective of the code is that the European Community achieve "interoperability" such that cards issued in one member state and belonging to a given card

[58] A "recommendation" solicits the voluntary cooperation of the member states and is nonbinding.

[59] Commission recommendation 87/62/EEC, *O.J.* No. L 33/10 (Feb. 4, 1987). The appendix provides an illustrative list of items that a member state may include within the term "exposure." A "large exposure" is when the exposure of a credit institution to a client or group of connected clients equals or exceeds 15 percent by value of the institution's own funds (i.e., capital adequacy) (see art. 3(2) of the annex). In general, the recommendation provides that (1) large exposures should be reported annually to the competent authorities (art. 3(1)); (2) exposures to a client or group of clients should not exceed 40 percent by value of the institution's reserve capital (art. 4(1)); and (3) aggregate large exposures should not exceed 800 percent of the institution's reserve capital (art. 4(2)). A directive on monitoring and controlling large exposures is expected in the near future.

[60] Commission recommendation 87/63/EEC, *O.J.* No. L 33/16 (Feb. 4, 1987). The recommendation provides that deposit guarantee schemes should reflect four broad conditions, including the requirement that such schemes cover the depositors of branches of credit institutions that have their head office in another member state. It is expected that a future directive will coordinate deposit insurance schemes.

A related proposed directive sets forth procedures for the reorganization and winding up (i.e., liquidation) of credit institutions. The proposal provides for home member state supervision of such measures (i.e., principle of unity), and such measures shall be fully effective in other member states (i.e., principle of universality)(art. 4). On the other hand, however, host member state control applies to third country branches (art. 8). Also, host member states must ensure that their deposit guarantee schemes cover the deposits of EC branches in their territory (art. 16(1)). On a transitional basis (i.e., until each member state has a deposit guarantee scheme), home member states with a deposit guarantee scheme must extend such schemes to cover branches of home member state credit institutions operating in a member state that has no scheme (art. 16(2)). This proposal is intended to contribute to the creation of an internal banking market by protecting shareholders, creditors, and depositors. See COM(88) 4, *O.J.* No. C 36/1 (Feb. 8, 1988).

[61] COM(87) 255, *O.J.* No. C 161/4 (June 19, 1987). For a discussion of the first draft proposal, see J. Welch, "A Common Market for Mortgage Credit," 23 *Common Market Law Review* (1986), p. 177.

[62] A "designated credit institution" is a credit institution covered by the First Banking Directive "all or part of whose activities consist of receiving funds from the public collected in the form of deposits or the proceeds from the issuing mortgage bonds or other bonds or securities or reimburseable shares and in granting loans to the public secured by mortgage on real property for the purpose of acquiring or retaining property rights in building land or in existing or projected buildings or for renovating or improving buildings" (art. 1).

[63] USITC staff conversations with representatives of the French Treasury and the EC Commission in April 1989 suggest that this proposal has encountered difficulty because member states have widely differing legal regimes for real property.

[64] *O.J.* No. L 365/72 (Dec. 24, 1987).

system may be used in other member states and/or other systems. This system would require that the cards and terminals be technologically compatible. Thereafter, traders and consumers could join the networks of their choice or contract with the issuer of their choice because each terminal would be able to process all cards. The EC expects that such an interoperable electronic payment system would contribute to the modernization of banking services, telecommunications, and information industries.

Possible effects

U.S. exports to the EC

As U.S. banks provide a service, commodity exports in the traditional sense do not exist. Although financial activities may originate in the United States, financial services by U.S.-based firms generally appear to be provided through branches or subsidiaries established in the EC. There is no information that can accurately quantify the amount of fees or revenues generated by U.S.-based financial firms operating in the EC from the United States or in the EC directly. Additionally, private industry, government, or trade association representatives contacted had no available information upon which to provide reliable data.

Diversion of trade to the U.S. market

Industry sources did not indicate that any diversion of trade would occur to the U.S. market as a result of the implementation of these directives. The banking industry in non-EC countries could be adversely affected if the "reciprocity" provisions are applied in a way that excludes third-country firms from operating in the EC.

In meetings with USITC staff in April 1989, many public and private sector officials in the EC indicated that Japan was the target of the reciprocity provisions. Since Japanese financial firms generally have been unrestricted in entering and operating in the United States, it appears unlikely that they would expand current activities in the U.S. market as a result of the implementation of the 1992 program. On the other hand, if Japan is found to be denying effective market access to EC firms and Japanese firms are restricted in the European Community, then Japanese firms might increase their activity in the United States.

U.S. investment and operating conditions in the EC

U.S. banking officials, U.S. Government officials and EC officials have indicated that it is difficult to anticipate how U.S. investment and operating conditions in the European Community will be affected by the 1992 banking program. Many of the proposals are the subject of ongoing negotiation and controversy within the European Community. Definitional and interpretive questions are raised by the rather broad scope of the directives and by the fact that each directive remains to be implemented in the national law of each member state.[65]

The Second Banking Directive.—The Second Banking Directive has raised the most concern among U.S. Government, private industry, and trade association representatives because of the "reciprocity" provision.[66] U.S. firms are concerned because the "reciprocity" provision may be applied in a way that would prevent U.S. firms, which are currently operating in the European Community or which may wish to operate there in the future, from obtaining a single banking license and undertaking any or all of the liberalized activities.

U.S. banking officials interviewed stated that they recognize that the single banking license would enable a duly authorized and supervised bank from any one of the 12 member states to establish branches and offer services to individuals and businesses freely across all borders in the EC. In addition, they stated that the broad scope of the enumerated activities in the annex would effectively introduce the possibility of universal banking throughout the European Community. Although member states are not required to introduce universal banking, member states that separate commercial banking activities from investment banking activities may remove such restrictions.

In accordance with the objectives of the White Paper, the banking directives would coordinate certain essential requirements and seek to bring uniformity to banking structures and operations throughout the European Community. Thereafter, EC and member state officials expect that market forces and competitive rulemaking will bring about a further approximation of regulatory systems. Although the EC expects that the 1992 banking program would largely liberalize and coordinate the regulatory regime that applies to the banking sector in the European Community, U.S. and EC firms will still be subject to 12 distinct national systems, which may have differing legal and regulatory traditions, including tax regimes, and customary and cultural barriers and biases.

In meetings with USITC staff, representatives of U.S. firms indicated that U.S. banks in the EC will be affected in much the same way that EC

[65] USITC staff held discussions regarding issues raised by the 1992 banking directives with EC Commission staff on Apr. 20, 1989.

[66] See, for example, position paper prepared by the Banker's Association for Foreign Trade entitled "Reciprocity: A Step in the Wrong Direction," (March 1989).

banks are affected, unless the single-market legislation either directly or indirectly restricts existing or future activity by U.S. firms. Industry sources indicate that all firms will have to make difficult strategic business decisions as the banking sector becomes more open and more competitive.

The EC expects that consumers of banking services would benefit from lower costs and access to a wider array of banking services in a larger geographic market. Whereas the wholesale banking market is already largely globally competitive for international banks and their customers, the retail market appears to be relatively more fragmented and protected. In the retail market, the Cecchini report found that wide disparities in costs to consumers and in profit margins for banks existed between various member states. Thus, even though the retail market is relatively expensive to enter due to the need to have an extensive branch network and customer base, the EC expects that individuals and small- and medium-sized firms in particular should have a wider choice of banking services.

Industry sources expect that banks should benefit from relatively greater economies of scale, as they would be able to sell a wider array of services in a larger geographic market. Representatives of U.S firms stated that banks would have the opportunity to reduce their operating costs by consolidating their management or their back-office operations, for example. The opportunity to sell cross-border banking services or to set up a branch that has standardized accounting and reporting requirements and does not have to be authorized or independently capitalized should also reduce operating costs. At the same time, U.S. firms expect that the competitive environment may bring operating and profit margins down.

Public and private sector sources do not expect all or even many firms to attempt to enter all product and geographic markets. They claim that the costs and risks would be too high. They indicate that it is more likely that firms will build on their strengths and focus on a certain specialized expertise, such as individual investment advice, financial leasing, or payment cards, for example.

Even with legal barriers to entry removed, firms will still have to overcome cultural barriers. In addition, the cost of establishing a competitive distribution network to sell a firm's products may be high. Private sector and governmental representatives expect, therefore, that a degree of consolidation and concentration will occur as firms seek suitable partners in either similar or complementary product or geographic markets.

Home-host supervision.—It is not clear how the allocation of supervisory responsibility between the home-member-state competent authority and the host-member-state competent authority will operate in practice. Whereas, according to the Second Banking Directive, the home member state has clear responsibility regarding authorization and supervision, the host member state has certain less defined responsibility regarding bank liquidity, monetary policy, reserve requirements for market risk, and other matters that "are justified on the grounds of the public good."

Representatives of public and private sector organizations suggested that the effective implementation of the home-host rule will depend on political will in the European Community and good-faith cooperation. They also noted that the European Court of Justice (ECJ) may be useful in providing some discipline and guidance, although they acknowledged that the ECJ procedure may not always be a practical and effective enforcement remedy because it does not yield quick results.

The treatment of third-country branches.—It is also not clear how the 1992 program will apply to branches of third-country banks. Two directives, the Branch Disclosure Directive and the Second Banking Directive, have provisions that are relevant to the treatment of branches of third-country banks. Whereas the EC Parliament sought to extend the coverage of the Second Banking Directive to branches of third-country banks, the current amended proposal applies only to subsidiaries. It is not clear whether this leaves member states free to regulate third-country branches solely under national law and without the discipline of EC law.

Under the 1992 banking legislation and the single license, host member states may no longer require the authorization, the independent capitalization, or the publication of annual accounting documents from branches of a firm with a single license. Representatives of U.S. banks stated that they are unsure of what, if anything, a host member state must require of branches of third-country banks, what a host member state is prohibited from requiring, and what a host member state may choose to require, regarding authorization, capitalization, accounting documents, disclosure obligations, or reporting and recordkeeping requirements, for example.

Representatives of U.S. banks were concerned about the extent of member-state discretion regarding the authorization and capitalization of third-country branches, for example. As far as the accounting documents of third-country branches are concerned, the Branch Disclosure Directive provides that if the legal form of the head office is "comparable" and the head office accounting documents are "in conformity with or equivalent to" EC accounting documents, then branches of U.S. banks would be treated the same as branches of EC banks. In conversations with USITC staff, EC Commission representatives stated that U.S. banks would meet these requirements and would be treated equally.

Representatives of U.S. banks were concerned, however, that they might not be treated equally for at least two reasons. First, branches of U.S. banks may not receive "more favorable treatment" than branches of EC banks. Second, the European Community may seek to accord branches of U.S. banks identical treatment throughout the European Community on the basis of reciprocity. Representatives of U.S. banks were concerned that, depending on how these provisions are implemented, interpreted, and applied, branches of U.S. banks may be subject to the burdens of the 1992 legislation regarding reporting, recordkeeping, and accounting, without being entitled to the benefits regarding authorization and capitalization. If, for example, branches of some EC banks in the United States had to provide annual branch accounting documents, then each member state may be required to make U.S. branches provide annual branch accounting documents.

Representatives of U.S. banks noted that the potential benefits of operating with a single license, combined with the uncertainty of how third-country branches will be treated, might result in U.S. banks establishing and operating through a subsidiary in the European Community. U.S. banks, though recognizing the potential benefits, were concerned about the higher costs of doing business through a subsidiary (e.g., higher tax and capital costs). In addition, U.S. banks that have existing branch networks in the European Community were concerned about the possible high cost and enormous burden of a corporate reorganization, although the cost would not be recurring. U.S. banks not presently in the European Community may face higher costs of entry to operate in the European Community.

Capital adequacy.—The Own Funds and Solvency Ratio Directives implement standards similar to the international capital adequacy standards already established by the international Committee on Banking Regulation and Supervision (the Basle Committee). The Basle Committee's standards on international capital adequacy were published in 1988. The Federal Reserve Board subsequently adopted the minimum capital guidelines for U.S. banks and holding companies. Therefore, the directives reflect standards that are comparable to U.S. standards and thus should not create any particular problems for U.S. firms.

Accounting requirements.—The Bank Accounting Coordination Directive addresses the coordination of accounting requirements for annual and consolidated accounts of credit institutions. Standard EC accounting terms and valuation rules are expected to promote transparency and comparability, and thus to facilitate regulatory supervision and to aid shareholders, investors, creditors, and savers. Since both EC and non-EC banks would be required to conform to the new standards, it would appear that this proposal would not create any particular problems for U.S. firms.

Winding-up.—The Winding-Up Directive deals with compensation schemes when a bank's operations are reorganized or terminated. This directive is likely to be policy neutral, with little real advantage or disadvantage for third-country credit and financial institutions. One trade publication indicated that some EC countries think that this directive is unnecessary, but it did not give an indication of whether the directive is likely to be trade liberalizing or discriminatory.

Mortgage credit.—The private sector views are mixed as to whether the Mortgage Credit Directive is trade liberalizing for non-EC suppliers. Even if equal access to the EC markets is obtained, one trade publication indicated that differing traditions and practices and currency risks will make it difficult for foreign banks to penetrate the mortgage markets of host countries. On the positive side for non-EC countries, the same publication indicated that foreign banks have made major gains in the recently liberalized mortgage market in the United Kingdom. The article also indicated that U.S. banks were already providing mortgage credit in the United Kingdom and Spain.

Electronic payment.—The European code of conduct relating to electronic payment appears to be technical and administrative in nature. Whereas all U.S. financial institutions with operations in the EC could be subject to this recommendation, it appears that those offering services to the retail sector (individual consumer banking as compared to commercial/business clients) would have the greatest concern given the potential market. The recommendation would serve to bring EC banks to a similar or higher level of technical sophistication as that in the United States. (Bank cards could be used interchangeably at automatic teller machines and point-of-sale terminals throughout the EC as charge/credit/debit cards.)

The language addressing the new system is somewhat vague. Nevertheless, one major financial institution based in the United States has indicated that a group of major financial institutions, including those based within and outside of the EC, are cooperating in developing and harmonizing the entire EC technical system and the cards themselves. As a result, it appears that all institutions that could be involved in the electronic payment system would be equally competitive.

U.S. Industry Response

The proposed Second Banking Directive has raised the most concern among U.S. financial firms, as it could significantly affect U.S. operating conditions in the EC by prohibiting

third-country institutions from offering all the services and operations that EC credit institutions will be allowed to carry out and by excluding new market entrants, depending on which definition of "reciprocity" is applied.

It appears that the retail/individual segment of the EC market is important to only a handful of large, New York-based money-center banks given the major expense and low profitability potential these operations generate. Over the last several years, a few U.S. banks have closed some of their offices in the EC due to disappointing returns on equity and profitability. One U.S.-based bank that 4 years ago had the third-largest network in terms of offices in the EC has closed or sold all but three of its offices in major cities.

Several industry contacts suggested that if the establishment of a subsidiary would allow them access to the EC through possible "grandfathering," these firms would incorporate subsidiaries prior to 1992.

Views of Interested Parties

No formal submissions were received.

Investment and Securities Services

The 1992 program for investment and securities services includes seven directives. The Investment Services Directive is the principal directive. Other directives deal with mutual funds, insider trading, public-offer prospectuses, the mutual recognition of listing particulars, and the disclosure of major shareholdings.

Background

The approach for the investment and securities services sector follows the approach for the banking sector. The EC Commission recognized that "it is necessary, for reasons of fair competition, to ensure that non-bank investment firms have similar freedoms to create branches and provide services across frontiers as those envisioned by the proposal for [the Second Banking Directive]."[67]

Anticipated Changes

Investment services

The proposed Investment Services Directive[68] is an "essential follow-up" to the Second Banking Directive. The proposed Investment Services Directive is similarly deemed to be "essential for achieving the internal market" (recital 1). The EC realized that without the Investment Services Directive, banks would have a comparative advantage over securities firms, in that banks would be able to carry out certain securities activities throughout the European Community on the basis of a single license, and investment firms could not.

The proposal would introduce a single authorization for an "investment firm,"[69] which would thereafter be able to engage in enumerated activities[70] relating to enumerated instruments[71] throughout the European Community subject to mutual recognition and home-member-state control. In principle, the Investment Services Directive would probably contribute to the freedom of establishment and the freedom to provide cross-border investment services for investment firms.

The Investment Services Directive, however, contains a "reciprocity" provision that is modeled on the original EC Commission proposal for a Second Banking Directive. The provision would apply to the authorization of third-country subsidiaries and to the acquisition of a participation in an EC investment firm by a third-country undertaking (art. 6). Thus, the extent to which U.S. firms will be able to participate in the creation of the single market for investment services is uncertain.

The issues raised by the reciprocity provision are similar to those raised in the Second Banking Directive.[72] The reciprocity provision would make the entry of third-country investment firms

[67] See recital 3 of the proposal for a directive on investment services in the securities field, COM(88) 778, *O.J.* No. C 43/7 (Feb. 22, 1989).

[68] COM(88) 778, *O.J.* No. C 43/7 (Feb. 22, 1989). For a general analysis of the Investment Services Directive by the British Securities Association, see "Investment Services Directive" (March 1989). For a general assessment of the issues raised by the investment services, insider trading, and public offer prospectus directives, see *1992 Investment Services*, (Linklaters & Paines [March 1989]).

[69] An "investment firm" is "any natural or legal person whose business it is to engage in one or more of the activities set out in the Annex" to the proposal. See art. 1 of the Investment Services Directive.

[70] Sec. A of the annex to the directive lists the activities that are covered by the single authorization, which include brokerage, dealing as a principal, market making, portfolio management, arranging or offering underwriting services, investment advice, and safekeeping and administration of certain enumerated instruments. It should be noted that some of these activities are also listed in the annex to the Second Banking Directive. When an investment firm is a credit institution that has been authorized as a credit institution under the Second Banking Directive to engage in investment activity, such an investment firm will not need to be authorized under the Investment Services Directive for the particular investment activity (art. 4(5)).

[71] Sec. B of the annex lists the instruments that may be the subject of the activities listed in sec. A, which include transferable securities including UCITS shares, money market instruments (including CDs and Eurocommercial paper), financial futures and options, and exchange rate and interest rate instruments. It should be noted that commodity futures, options, and forward contracts are not included.

[72] See the banking sector section of this chapter. Unlike banks in the United States, however, which are subject to product and geographic restrictions, U.S. investment firms may engage in the entire range of activities covered in the Investment Services Directive. Also, according to the explanatory memorandum that accompanied the proposal, the reciprocity provision does not apply to investment firms already established and authorized to operate in the European Community.

dependent on "whether all Community investment firms enjoy reciprocal treatment" (however defined) in the third country concerned. If the EC Commission determines that reciprocity is not granted to all EC investment firms, it is empowered to direct the suspension of the application.

As in the banking sector under the original EC Commission proposal, U.S. firms are not sure whether the EC Commission would determine that the United States provides "reciprocal treatment." It should be noted, however, that the EC's approach to reciprocity and the treatment of third-country investment firms is expected to follow the more flexible approach taken in the banking sector under the amended EC Commission proposal, although there has been no formal linkage.[73]

Home-country authorization.—The proposed Investment Services Directive would harmonize certain authorization and supervisory conditions that are considered necessary and sufficient to allow investment firms to operate with a single license. The home-member-state competent authority[74] would have to ensure that the investment firm had "sufficient initial financial resources,"[75] that the persons running the firm are of "sufficiently good repute and experience," and that persons capable of exercising a significant influence on the firm are "suitable" (art. 4(2)).

Investment firms would also have to file with the home member state a program of operations that sets out at least the structural organization of the firm and the types of business to be undertaken (art. 4(3)). The home member state would ensure continuing compliance by an authorized investment firm and would require that such firms "make sufficient provisions against market risk" (art. 8(1)).[76]

The proposal would require member states to establish prudential rules regarding sound administrative and accounting procedures and internal control mechanisms, the segregation of investors' and firms' shares and funds, respectively, a general compensation scheme for investors in the case of a firm's bankruptcy or default, a firm's disclosure obligations regarding financial soundness and market risk, the maintenance of records and the minimization of conflicts of interest (art. 9(1)). The home member state would supervise compliance with these rules. A limited exception is provided for business and professional investors (art. 9(3)). In implementing the directive, each member state would establish its own prudential rules consistent with the broad standards set out in the directive.

Host-country responsibility.—Once authorized, an investment firm may carry out the enumerated activities throughout the European Community either by the establishment of a branch or through the cross-border provision of services. The host member state may not subject such a firm to an authorization requirement, or to a requirement to provide endowment capital or any measure having equivalent effect.

The host member state must ensure that such investment firms may "enjoy the full range of trading privileges" accorded to host-member-state members of stock exchanges and securities markets (art. 10(3)). Moreover, the host member state must ensure that such investment firms may become members of stock exchanges or securities markets either through a branch, a subsidiary or through the acquisition of an existing member firm (art. 10(4)). Pending future harmonization, the host member state may, however, oversee the relationship between investment firms and their clients (i.e., conduct of business rules regarding, for example, advertising and marketing), so long as the host-member-state rules are justified on the grounds of the public good (art. 13).

Ancillary directives

The Investment Services Directive is one of a group of securities directives which, along with the Second Banking Directive and in conjunction with the capital movements directives, should allow and encourage the creation of an internal

[73] USITC staff held discussions regarding issues raised by the 1992 Investment Services and Securities Directives with representatives of the EC Commission on Apr. 21, 1989. According to EC officials, the approach of the Investment Services Directive is expected to follow the Second Banking Directive, although there has been no formal linkage. Most representatives of public and private sector organizations expect the Investment Services Directive's reciprocity provision to follow the new approach taken in the banking directive. Many commentators have advocated the simultaneous implementation of the two directives so that banks would not have the prior benefit of the single license to engage in investment activities. A British official noted that this is especially important for U.S. firms whose investment banking activities are usually carried out through an investment firm. It is relatively less important for firms whose investment banking activities are carried out through a universal bank structure because they would get the benefit of a single license under the banking directive. It should also be noted that the investment activities in the respective annexes will probably be aligned.

[74] Art. 15 of the proposal provides that "[w]here there are several competent authorities in the same Member State they shall collaborate closely in order to supervise the activities of investment firms operating there." Also, the competent authorities "responsible for supervising credit and other financial institutions and insurance companies" are expected to collaborate (art. 15(2)), and the competent authorities of the home and host member states are expected to collaborate. Finally, member states may negotiate cooperation agreements and exchange information with third countries (art. 17(3)).

[75] It should be noted that the Second Banking Directive would require that the initial paid up capital of a credit institution be at least 5 million ECU.

[76] The EC Commission expects to propose a coordinating directive on the capital to be set aside by investment firms to reflect market risk.

securities market in the European Community. The other securities directives deal with mutual funds (i.e., called UCITS), the mutual recognition of listing particulars, public-offer prospectuses, the disclosure of major shareholdings, and insider trading.

Mutual funds.—The UCITS Coordination Directive[77] establishes standard rules regarding the authorization, supervision, structure, investment policies,[78] and activities of a UCITS[79] in the European Community. The directive provides that a duly authorized UCITS may sell its shares throughout the European Community on the basis of home-member-state control. Consistent with the policy of protecting investors and promoting competition and transparency, the directive provides that a UCITS must publish a prospectus, an annual report, and a half-yearly report (art. 27). Also, a UCITS must make public the price of its shares each time it issues, sells, repurchases, or redeems them, and at least twice a month (art. 34). The effect of this coordination should be to remove restrictions on cross-border dealing, thereby enabling shares of UCITS to be traded freely within the European Community.[80]

Stock exchange directives.—Public confidence in securities markets should attract risk capital for investment, and public confidence depends largely on reliable, public information regarding securities and the issuers of securities. Prior to the 1992 program, the EC Council adopted three stock market directives that provide information to investors and promote market transparency. These directives coordinate the conditions for the admission of securities to official stock exchange listing (Admission Directive),[81] specify the listing particulars to be published for the admission of securities to official stock exchange listing (Listing Particulars Directive)[82] and specify the information to be published on a regular basis by companies whose shares have been listed.[83]

Under the Listing Particulars Directive, however, listing particulars still had to be drawn up for each member state where the securities were to be admitted. Moreover, the directive provided that, when securities were to be admitted to stock exchanges in two or more member states, the competent authorities of such member states should cooperate and endeavor to agree to a single text for the listing particulars.[84]

The need to provide listing particulars in each member state where securities were to be admitted and the need for the competent authorities to "cooperate" and "agree to a single text" operated as a burden on cross-border listings, according to the EC. In order to eliminate this obstacle to cross-border listings, the Mutual Recognition of Listing Particulars Directive[85] modifies article 24 of the Listing Particulars Directive to provide for mutual recognition of listing particulars[86] when applications for admission of the same securities are made to stock exchanges in different member states "simultaneously or within a short interval."[87]

Public-offer prospectuses.—Whereas the stock exchange directives deal with the disclosure of information regarding securities that have been

[77] Council directive 85/611/EEC, *O.J.* No. L 375/3 (Dec. 31, 1985). This directive will become effective on Oct. 1, 1989.

[78] Council directive 88/220/EEC amended art. 22 of the UCITS Coordination Directive to modify the restrictions on the investment policy for UCITS. *O.J.* No. L 100/31 (Apr. 19, 1988). This directive will become effective on Oct. 1, 1989. In general, a UCITS may hold no more than 5 percent of its assets in the transferable securities of the same issuer, except under certain narrow conditions. Directive 88/220/EEC enables a UCITS to hold up to 25 percent of its assets in certain private sector bonds issued by one issuer, and up to 80 percent of its total assets in this type of private sector bond, as long as special guarantees are provided to the investor under specific member state rules.

[79] A "UCITS" is an *U*ndertaking for *C*ollective *I*nvestment in *T*ransferable Securities. An example of a type of UCITS in the United States that would be covered by the directive is an open ended mutual fund. The UCITS covered by the directive may be organized either with a corporate structure or with other than a corporate structure (art. 1(3)). The collective investment undertakings with a corporate structure are similar to public limited companies and are called "investment companies" in the directive. The collective investment undertakings with other than a corporate structure (called "unit trusts" in the directive) are organized under contract or trust law and consist of a management company, a depositary company, and the trust fund.

[80] It should be noted that Council directive 85/583/EEC removed the restrictions on the free movement of UCITS shares. *O.J.* No. L 372/39 (Dec. 31, 1985). The liberalization applies to shares of unit trusts, whether or not traded on an exchange, and to shares of investment companies not traded on an exchange. The movement of shares of investment companies traded on an exchange were liberalized in the First Council Directive of May 11, 1960, *O.J.* No. 43/921 (July 12, 1960).

[81] Council directive 79/279/EEC, *O.J.* No. L 66 (Mar. 16, 1979).

[82] Listing particulars contain information about the issuer and the securities for which admission is sought, which is necessary to enable investors and investment advisors to evaluate such securities. See arts. 3 and 4 of the Listing Particulars Directive, 80/390/EEC, *O.J.* No. L 100 (Apr. 17, 1980).

[83] Council directive 82/121/EEC, *O.J.* No. L 48 (Feb. 20, 1982).

[84] It should be noted that Council directive 86/566/EEC abolished exchange control restrictions on the admission of securities to official stock exchange listings as of Mar. 1, 1987. *O.J.* No. L 332/22 (Nov. 26, 1986).

[85] Council directive 87/345/EEC, *O.J.* No. L 185/81 (July 4, 1987). This directive will become effective on Jan. 1, 1990.

[86] A related proposed directive would provide that a public offer prospectus must be recognized as listing particulars. See COM(89) 133, *O.J.* No. C 101/13 (Apr. 22, 1989).

[87] It should be noted that the directive provides that the European Community may agree with third countries to recognize non EC listing particulars, subject to reciprocity, provided that the non EC rules provide "equivalent protection" to investors (art. 1).

listed on an official stock exchange, the Public Offer Prospectus Directive[88] would provide safeguards for the protection of actual and potential investors when transferable securities[89] are offered to the public[90] for the first time, provided such securities are not already listed. The directive is intended by the EC to provide the equivalent safeguards associated with admission to official stock exchange listing.

The information required in the prospectus is comparable to the information required in the listing particulars. When a public offer relates to securities that are sought to be listed, then the prospectus should be prepared in accordance with the Listing Particulars Directive (art. 7). When the public offer concerns securities that are not sought to be listed, then the prospectus must contain information "necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer and of the rights attaching to the transferable securities" (art. 11). The directive would provide for mutual recognition of prospectuses (art. 21).[91]

The EC expects that the coordination of the requirement for and content of prospectuses should achieve equivalence of investor protection and should encourage the interpenetration of national securities markets. Standard prospectuses and mutual recognition should facilitate offers of securities, as well as the admission to an official listing, on a cross-border basis.

The disclosure obligations of shareholders.—The Listing Particulars Directive requires the issuer to disclose the shareholders who hold a proportion of the issuer's capital, "in so far as they are known to the issuer." The Admission Directive requires companies to inform the public of changes in the structure of the major holdings in its capital "as soon as such changes come to its notice." The Anti-Raider Directive[92] would facilitate the effectiveness of companies' disclosure obligations by requiring persons acquiring or disposing of major shareholdings in a listed company to inform that company accordingly.

The disclosure obligation applies to legal entities and natural persons who acquire or dispose of, directly or through intermediaries, a major holding in the voting rights of a company whose shares are officially listed on a stock exchange in a member state (art. 1). A "major holding" is defined as 10 percent, 20 percent, 33.33 percent, 50 percent or 66.66 percent of the voting rights (art. 4). When a person's holding reaches, exceeds, or goes below these thresholds, the company and the competent authorities must be notified, within 7 calendar days, of the actual percentage of voting rights held by the shareholder (art. 4). Thereafter, the company must notify the public within 9 days in each relevant member state (art. 10).

The EC Commission expects that prompt disclosure should provide equivalent protection to investors and that such coordination should "help to establish a true European capital market" (recital 2).

Insider trading.—Whereas the other securities directives provide for the prompt disclosure of market information, the proposed Insider Trading Directive[93] would prohibit the use of certain nonpublic information. Several member states do not currently have rules prohibiting insider trading, or the rules that exist may have no sanctions. Moreover, existing rules on insider trading in the member states differ markedly. The proposal would introduce and coordinate EC rules on insider trading and provides for cooperation between the competent authorities.

Article 1 would require each member state to prohibit any person who acquires inside information in the course of employment from taking advantage of that information to buy or sell in the member state, either directly or indirectly, transferable securities admitted to trading on the stock exchange markets in the member state. Such primary insiders could not disclose, except in the normal course of employment, or use inside information (art. 2). In addition, so-called secondary insiders who knowingly obtain inside information from primary insiders could not disclose or use inside information (art. 3).

The directive would define inside information as information that is inaccessible or not available to the public. The information must be of a specific nature and must relate to transferable securities or the issuers thereof. Moreover, the

[88] Council directive 89/298/EEC, *O.J.* No. L 124/8 (May 5, 1989). The directive became effective on Apr. 17, 1989.

[89] It should be noted that draft proposals applied to the issuance of Euro securities, whereas art. 2 of the directive provides that the directive does not apply to certain types of offers and to certain types of transferable securities, including certain "Euro securities" as defined in art. 3(f).

[90] Recital 7 of the directive notes that, "it has proved impossible to furnish a common definition of the term 'public offer' and all its constituent parts."

[91] Art. 24 provides that, "[t]he Community may . . . recognize public offer prospectuses drawn up and scrutinized in accordance with the rules of the non member country . . ., subject to reciprocity," provided that the third country rules provide investors with equivalent protection.

[92] Council directive 88/627/EEC, *O.J.* No. L 348/62 (Dec. 17, 1988). The directive will become effective no later than Jan. 1, 1991.

[93] The amended proposal was COM(88) 549, *O.J.* No. C 277/13 (Oct. 27, 1988). The original proposal was COM(87) 111, *O.J.* No. C 153/8 (June 11, 1987). The EC Council reportedly reached a common position on the amended proposal at their June meeting.

information must be such that it would have a material effect on the price of the securities, if it were published (art. 6).

Possible Effects

U.S. exports to the EC

According to industry sources, the investment services and securities directives have the potential to be trade liberalizing for U.S. financial institutions (banks, securities firms, and mutual funds) operating in the EC market. By seeking to coordinate various EC securities regulations, the European Community is seeking to create the necessary framework for the creation of an integrated European financial market. As such, these directives complement the capital movements directives, which permit investment capital to flow across EC borders. U.S. financial intermediaries located in the EC would be expected to benefit from the deregulation of EC financial markets provided they have equal rights with EC-owned financial institutions to market their services throughout the European Community.

Diversion of trade to the U.S. market

Because the subject directives, in the absence of restrictive applications of the reciprocity provision, are considered likely to expand trading opportunities for non-EC financial services institutions, there is likely to be no diversion of trade to the U.S. market. Japan is the third country most likely to be affected by any EC restrictions. Japanese financial companies are already in the U.S. market, and any continued expansion would be independent of any developments in EC integration. On the other hand, if Japanese securities firms, or firms from other third countries, were excluded from the EC market, then it is possible that they would seek to expand their activity in the United States.

U.S. investment and operating conditions in the EC

It is difficult to anticipate how U.S. investment and operating conditions in the EC will be affected by the 1992 securities program. Many of the same general issues that are raised by the banking directives are also raised by the investment services and securities directives. Some of the issues relate to how U.S. branches will be treated, how the home-host rule will be applied, and how "public good" will be interpreted. Answers to these questions will be resolved on a case-by-case basis as member states implement the 1992 legislation and as the respective competent authorities begin to cooperate in administering the new legislation.[94]

[94] USITC staff held discussions regarding issues raised by the 1992 investment services and securities directives with representatives of the EC Commission on Apr. 21, 1989.

In general, U.S. firms will be affected in much the same way that EC firms are affected, unless the reciprocity provisions preclude U.S. firms from operating in the EC market.

Investment services.—The Investment Services Directive is modeled on the Second Banking Directive. However, there are even more questions raised by the Investment Services Directive because less regulatory detail is provided. Member states are given little guidance as to which standards govern accounting requirements, compensation schemes, segregation of funds, or disclosure obligations, for example. No figure is provided regarding minimum initial capital, and no capital adequacy figures are provided regarding market risk.

The lack of detail means that member states have even greater discretion and fewer parameters in implementing the securities directives. The lack of clear guidance also makes it difficult for U.S. business to determine a business strategy. In conversations with USITC staff, public and private sector representatives indicated that competitive lawmaking is anticipated, and market forces are expected to bring about an approximation of regulatory systems.

The treatment of third-country branches.—The treatment of U.S. branches is unclear for at least two reasons. First, unlike the banking directive, the Investment Services Directive may apply directly to third-country branches. The directive covers "investment firms," which are broadly defined and may be interpreted to include branches of U.S. firms. Second, third country branches may not be treated "more favorably." Therefore, even if branches are not covered directly by the directive, the extent of member state discretion to regulate third-country branches free of EC-law discipline is not clear.

Home-host supervision.—The European Community is currently discussing how to apply the home-host rule to conduct-of-business rules and compensation schemes, for example, and they are trying to reach an agreement on market risk. It is not clear whether there will be one market risk regime that applies to both banks and investment firms or whether there will be two regimes.

According to USITC staff conversations with EC Commission officials in April 1989, some member states favor a high figure which would operate to guarantee the solvency and stability of a firm, whereas other member states favor the adoption of a market-risk standard based on the various types of risk. It is not possible to anticipate how these unresolved questions may affect U.S. firms.

Recordkeeping and information disclosure.—U.S. firms recognize that the coordination of minimum essential requirements and the liberalization of investment and securities services may create potential business opportunities. U.S. firms generally support the coordination of recordkeeping and information-disclosure obligations as long as the obligations apply equally to all market participants. U.S. firms believe that such efforts will reduce the cost of regulatory compliance and will be good for firms and the markets.

The EC expects that greater coordination should promote transparency and comparability, thereby favoring investors, creditors, shareholders, savers, and other market participants. Some commentators were not overly concerned about the possibility of minimum supervision resulting from competitive rulemaking because they expect that firms will seek well-regulated markets, even if the costs and disclosure obligations were relatively higher.

The various investment services and securities directives are drafted to protect individual investors who wish to invest in EC capital markets through the coordination of various member-state regulations relating, for example, to the timely reporting of financial information in stock exchange listing particulars and the reporting of the same information in securities prospectuses. However, some market observers note that an EC-wide standard may cause the European Community to adopt reporting requirements that are less stringent than those that presently exist. If a weaker EC standard is adopted, investors could possibly suffer as less financial information may be reported. On the other hand, two proposals raised concerns that the European Community may adopt too high of a standard and thereby risk stifling the market or driving it offshore.

Insider trading.—Some representatives in the investment banking community suggested that the draft Insider Trading Directive is so widely drawn that it may hinder firms in such legitimate activities as market stabilization, market research, or arbitrage.[95] The proposal contains a relatively broad definition of insider, and a broad definition of inside information, and the proposal has a relatively easier burden of proof in that knowledge is not a required element.

Representatives of the EC Commission acknowledged that the directive had a broad sweep but noted that the trend in the European Community is towards adopting such tough legislation. Most firms view the directive in general as a positive step to promote investor confidence in EC capital markets and hope that any objectionable features of the proposal can be removed before enactment.

Public-offer prospectuses.—The Public Offer Prospectus Directive raised similar concerns because original drafts were seen to be overly broad. Whereas the final directive excluded Euro-securities,[96] earlier drafts would have required issuers of Euro-securities to publish a prospectus for each issue and in each member state. Some commentators thought that such a requirement might drive the Euro-securities market offshore. It should be noted that, although the current proposal does not require member states to impose a prospectus requirement on Euro-securities offerings, member states are free to do so if they choose.

Industry sources indicate that in the absence of a stringent application of the article 6 reciprocity provision, U.S. investment banks, securities firms, and mutual funds are likely to benefit from the various provisions relating to freedom of establishment and freedom to provide services.

U.S. Industry Response

Interviews with officials at leading U.S. financial services firms indicate that, if U.S. financial services firms are subject to national treatment, they are likely to cross EC borders to establish subsidiaries and branches in order to trade securities, to underwrite the issuing of securities, to market mutual funds, and to provide other services normally provided by these financial institutions. Interviews with officials at U.S. financial services firms in the EC indicate general support for these directives provided a stringent reciprocity provision is not applied.

Views of interested parties

No formal submissions were received.

Insurance Services

The 1992 program includes nine insurance directives. The two main directives are the Second (nonlife) Directive and the Second (life) Directive. The other directives cover accounting requirements, credit and suretyship insurance, legal expenses insurance, auto insurance, insurance contracts, and compensation schemes for the reorganization and winding-up of an insurance firm.

[95] See *1992 Investment Services,* (Linklaters & Paines [March 1989]).

[96] Art. 3(f) of the Public Offer Prospectus Directive defines "Euro securities" as "transferable securities which . . . [(1)] are to be underwritten and distributed by a syndicate at least two of the members of which have their registered offices in different States, and . . . [(2)] are offered on a significant scale in one or more States other than that of the issuer's registered office, and . . . [(3)] may be subscribed for or initially acquired only through a credit institution or other financial institution."

Background

The First (nonlife) Insurance Directive[97] coordinated the laws relating to the taking up and pursuit of the nonlife insurance business, thereby contributing to the right of establishment in the insurance sector. This directive covers the legal form of insurance firms, restrictions on firms' insurance and related activities, supervision by and cooperation between member state authorities, rules on technical reserves, assets, solvency margins and minimum-guarantee funds, and procedures for setting up branches and subsidiaries.

The First (life) Insurance Directive[98] coordinated the laws for the life insurance business. According to the EC, the directives have been largely effective in facilitating the freedom of establishment for the life and nonlife insurance business (although not with the benefit of the single license). On the other hand, national controls have largely precluded the effective exercise of the freedom to provide services on a cross-border basis. The 1992 program seeks to provide freedom of services for the life and nonlife insurance business.

Anticipated Changes

Nonlife insurance

The Second (nonlife) Insurance Directive[99] amends and supplements the First (nonlife) Directive to clarify the powers of supervisory authorities and to establish specific rules on the cross-border provision of insurance services. The directive provides for the cross-border provision of insurance services on the basis of the principle of home-country control for "large risks".[100] On the other hand, the directive recognizes another class of policyholders for whom it is desirable for a member state to provide adequate protection. In the latter case, known as "mass risks," the supervisory rules of the country of risk (i.e., host-country control) apply, pending subsequent coordination of prudential rules including those on technical reserves.[101]

The EC intends that this directive will contribute to the creation of an internal insurance market by enabling insurance firms to provide "large risk" insurance throughout the European Community on a cross-border basis, and "large risk" policyholders will be able to buy insurance throughout the European Community.[102]

Life insurance

The proposed Second (life) Insurance Directive[103] follows the approach of the Second (nonlife) Directive. The Second (life) Directive would amend and supplement the First (life) Directive in order to establish rules on the cross-border provision of life insurance services and to clarify the powers of the supervisory authorities. The Second (life) Directive would distinguish between policyholders who require adequate protection and those who do not. Life insurance issued to the former group would be subject to the law of the country of commitment (i.e., usually where the policyholder is resident), whereas life insurance issued to the latter group would be subject to the supervisory law of the country of establishment (i.e., home-country control).

The regulatory regime sought to be established by this proposed directive does not extend the concept of the single license as far as in the banking and securities field. The proposal would provide for home-member-state control when an individual seeks to buy insurance from a firm in another member state (i.e., "passive" freedom of insurance services). On the other hand, when an insurance firm actively seeks to sell its services on a cross-border basis, then host-member-state control would apply (i.e., "active" freedom of insurance services). Therefore, the single-license concept only extends to the "passive" freedom of insurance services.

The test for determining which law applies depends on the status of the policyholder. In this regard, the proposal would provide that persons who take the initiative in seeking life insurance in another member state are deemed to be not in need of protection.[104] Such persons are deemed

[97] First Council Directive 73/239/EEC, *O.J.* No. L 228/3 (Aug. 16, 1973).
[98] First Council Directive 79/267/EEC, *O.J.* No. L 63/1 (Mar. 13, 1979).
[99] Second Council Directive 88/357/EEC, *O.J.* No. L 172/1 (July 4, 1988).
[100] Large risks are, in general, policyholders who, by virtue of their status, their size, or the nature of the risk, are not considered to require special protection of EC or member state law because they are capable of protecting their own interests and deciding from whom they should buy insurance. See art. 5 of the directive for a precise definition.
[101] It should be noted that a proposal on the freedom of insurance services for "mass risks" may be taken up in the future.
[102] It should be noted that EC Commission proposal (88) 791, *O.J.* No. C 65/6 (Mar. 15, 1989), would extend the coordination of the Second (nonlife) Directive to the freedom to provide insurance services against civil liability regarding motor vehicles (other than carrier's liability). The proposal would effectively extend the rule of home member state control for cross border services to large risks in the field of motor insurance. The proposal would tend to be trade liberalizing since it would promote competition in the "large risk" market, and such industrial and commercial customers would be able to purchase insurance throughout the European Community. It also should be noted that a proposal has been made that would provide that compulsory motor insurance policies must cover personal injury liability for all passengers in the entire territory of the European Community. See COM(88) 644; *O.J.* No. C 16/12 (Jan. 20, 1989).
[103] Second Council Directive, COM(88) 729, *O.J.* No. C 38/7 (Feb. 15, 1989).
[104] It should be noted that although some member states restrict or prohibit their nationals from initiating and entering into contracts abroad, Council directive 88/361/EEC provides for the full liberalization of capital movements as of July 1, 1990.

by their action to willingly and knowingly give up protection of the law of the member state of residence. The effect of this proposal would be to enable persons to seek life insurance throughout the European Community. On the other hand, when insurance firms seek to sell their life insurance services throughout the European Community, policyholders will be protected by the law of the member state of residence.

It should be noted that article 9 contains a reciprocity provision that is closely modeled after the Second Banking Directive. The reciprocity provision would apply to subsidiaries of U.S. firms and to the acquisition by a U.S. firm of a controlling participation in an EC insurance firm. At this time, U.S. firms are not sure of how the reciprocity provision will be interpreted and applied.[105]

Specialization requirements

In addition to the two main directives, the ancillary directives should be considered. Article 7(2)(c) of the First (nonlife) Insurance Directive provided an exception "pending further coordination" that enabled member states to require specialization of insurance firms that offered credit and suretyship insurance or legal expenses insurance in their territory. In such a case, a member state could require that a firm that offered credit and suretyship insurance or legal expenses insurance could offer no other class of insurance. The EC recognized that these restrictions operated as barriers to the free establishment of insurance agencies and branches in such countries. The Council has adopted two directives that eliminated these specialization requirements.

Credit and suretyship insurance.—The Credit and Suretyship Insurance Directive[106] removes the restriction on the simultaneous undertaking of credit and suretyship insurance along with other classes of insurance. The directive introduces additional financial guarantees for consumers of credit insurance, whereas the interests of insured persons were thought to be sufficiently safeguarded as regards suretyship insurance.

The subject directive amended the First (nonlife) Insurance Directive to require, in the case of firms[107] that offer credit insurance, an "equalization reserve" and an increase in the guarantee fund, which is to be phased in over a 7-year period. The equalization reserve, which does not form part of the solvency margin, is required when the premiums in respect of credit insurance are 4 percent or more of the total premiums receivable and are 2.5 million ECU or more. Such a reserve is to be used to offset any technical deficit or above-average claims ratio. Four methods of calculating the equalization reserve are set forth in an annex. The subject directive is expected by the EC to improve the guarantees for consumers and third parties and to promote the freedom of establishment of insurance firms.

Legal expenses insurance.—The Legal Expenses Insurance Directive[108] coordinates the provisions concerning legal expenses insurance in order to facilitate freedom of establishment and minimizes any conflicts of interest that may arise between the insurer and the insured (art. 1). Conflicts of interest may arise when the same insurance company is responsible for both the legal protection of, as well as the claim against, the insured.

The directive provides that member states must abolish any restrictions on offering legal expenses insurance along with other classes of insurance (art. 8). The directive applies to legal expenses insurance that covers securing compensation for injury to the insured party or defending claims against the insured party (art. 3). The directive does not apply to certain excluded legal expenses insurance, including certain automobile insurance and insurance concerning seagoing vessels (art. 2(2)).

The directive introduces a series of administrative and organizational requirements that enable firms to offer legal expenses insurance along with other classes of insurance. First, legal expenses coverage must be in a separate contract or, alternatively, in a separate section of a single policy, which reflects the nature of the coverage and the amount of the relevant premium (art. 3(1)). Additionally, firms must provide for separate management of legal expenses claims or legal advice related thereto, or firms may set up a legally separate undertaking to manage such insurance, or firms may allow the insured person to select a lawyer "from the moment that he has

[105] The issues raised by the reciprocity provision in the Second (life) Insurance Directive are similar to the issues raised by the reciprocity provisions in the Second Banking Directive and the Investment Services Directive. U.S. firms are not sure of whether the EC Commission would find that "all undertakings of the Community enjoy reciprocal treatment" (however defined) in the United States, particularly in light of the fact that insurance firms are regulated by the States. The EC's treatment of third country firms in the insurance sector may follow the more flexible approach taken in the amended proposal for a Second Banking Directive. This issue is covered in the banking sector section of this chapter.

[106] Council directive 87/343/EEC, *O.J.* No. L 185/72 (July 4, 1987). The directive becomes effective on July 1, 1990.

[107] In conversations with USITC staff, representatives of the International Chamber of Commerce suggested that concerns have arisen in the insurance sector regarding the scope of the subject directive. The directive is binding only on privately owned insurance firms and, therefore, may give state owned firms a competitive advantage in the area of export credit insurance.

[108] Council directive 87/344/EEC, *O.J.* No. L 185/77 (July 4, 1987). The directive becomes effective on July 1, 1990.

the right to claim from his insurer under the policy" (art. 3(2)).

The contract must expressly recognize that the insured person must be able to choose a lawyer to act during any "inquiry or proceedings," or when a conflict of interest arises (art. 4). The contract must also provide for the arbitration of disputes (art. 6). The EC expects that this directive should protect policyholders throughout the European Community by minimizing conflicts of interest and promoting the free establishment of insurance firms by removing the compulsory specialization requirement.

Accounting requirements

The proposed Insurance Accounting Directive[109] would generally extend the coordination of the Fourth[110] and Seventh[111] Company Directives to insurance firms (arts. 1 and 59).[112] However, the proposed directive provides some exceptions from the coordination directives as well as some additional special rules that take into account the characteristics of insurance firms.

The proposal would apply to all insurance firms covered by the First (life)[113] and First (nonlife)[114] Directives, except small mutual associations, and to specialist reinsurance firms (art. 2). The proposal would also apply to Lloyd's of London in principle, with considerable adjustment due to its particular nature and structure (art. 3). The EC Commission would study and report on the necessary adaptations. The EC expects that the coordination of accounting requirements for insurance firms should improve the comparability of annual accounts and consolidated accounts and facilitate the integration of the EC insurance market and protect creditors, debtors, members, policyholders, and the general public.

Winding-up

The Second (nonlife) Directive did not harmonize rules on the treatment of insurance contracts when an insurance firm is wound up or its assets are distributed. Proposed directive (86) 768[115] would harmonize the laws relating to the compulsory winding-up of insurance firms. The proposal covers insurance firms that are subject to the First (life) and First (nonlife) Directives (art. 1). Such firms would be required to keep a register of the assets representing the technical reserves corresponding to the direct insurance transactions and reinsurance acceptances managed by the head office.

It should be noted that the calculation of the reserves and the valuation of the assets are governed by national law. The registers are considered internal documents of the firm, although the register must be lodged with the supervisory authorities when the free disposal of assets is restricted or prohibited (art. 3).

If a firm's authorization is withdrawn, or the conditions for withdrawal are satisfied, then the firm must be automatically wound up. Such compulsory winding-up is deemed to be a special compulsory winding-up (SCW)[116] if the firm is in proven or probable insolvency; otherwise, it is deemed a normal compulsory winding-up (NCW) (art. 4).[117] In either case, once authorization has been withdrawn, the firm may no longer wind up voluntarily.[118]

Insurance contracts

The proposed Insurance Contracts Directive[119] is intended to contribute to the effective exercise of the freedom to supply nonlife insurance services on a cross-border basis by coordinating the EC laws relating to nonlife insurance contracts. The coordination applies to nonlife insurance contracts covering risks situated in the European Community and relating to one of the classes of insurance set forth in point A of the annex to the First (nonlife) Directive (art. 1). The coordination does not apply to marine, aviation, transport, credit, suretyship or sickness insurance (art. 1).

The coordination covers the information that must be included in a policy (art. 2), the rights and obligations of the policyholder and the insurer regarding declaration of risk, changed

[109] COM(86) 764, *O.J.* No. C 131/1 (May 18, 1987).
[110] Fourth Council Directive 78/660/EEC, *O.J.* No. L 222/11 (Aug. 14, 1978).
[111] Seventh Council Directive 83/349/EEC, *O.J.* No. L 193/1 (July 18, 1983).
[112] A comparable directive on the annual and consolidated accounts of banks and other financial institutions has been adopted. Council directive 86/635/EEC, *O.J.* No. L 372/1 (Dec. 31, 1986).
[113] First Council Directive 79/267/EEC, *O.J.* No. L 63/1 (Mar. 13, 1979).
[114] First Council Directive 73/239/EEC, *O.J.* No. L 228/3 (Aug. 16, 1973).
[115] *O.J.* No. C 71/5 (Mar. 19, 1987).
[116] An SCW is ordered by either the supervisory authority or the courts and is supervised by a liquidator (arts. 10 to 11). The proposal sets forth rules on whether and when the portfolio may be transferred (art. 13) and contracts may be terminated (arts. 14 to 16). Assets entered in the register should be realized, and the proceeds therefrom should be distributed to creditors with eligible claims in a specified order of priority (arts. 17 to 19).
[117] An NCW shall be carried out by the firm under the supervision of the supervisory authority (art. 5). Under certain circumstances, an administrator may be appointed by the supervisory authority to wind up the firm. The proposal provides for the rapid and orderly winding up of the firm and protects the interests of the insured. The objective is to provide for the termination or surrender of contracts, or their natural maturity, the satisfaction of incurred and reported claims, the lodging with a trustee of reserves for future claims, and the transfer of the portfolio (art. 9).
[118] It should be noted that special rules are provided for branches and agencies of non EC firms (art. 21).
[119] COM(80) 854, *O.J.* No. C 355 (Dec. 31, 1981). The original proposal was COM(79) 355, *O.J.* No. C 190/2 (July 28, 1979).

circumstances, amendments, the payment of premiums, declaration of a claimable event, duration of the contract, termination, and third parties. Article 2(5) provides that the contract document is to be drafted in the language of the member state whose law is applicable, as determined by the Second (nonlife) Directive. It should be noted that the proposed Insurance Contracts Directive sets minimum standards and that parties to the contract may agree to more favorable terms for the policyholder, insured person, or injured third party (art. 12).

Possible effects

U.S. exports to the EC

The total world private market for insurance, for life and nonlife (e.g., property and casualty) policies, is roughly $1 trillion in annual premiums.[120] According to industry sources, the 12 nations of the EC account for about 22 percent of the total (the United States has about 43 percent of the global total and Japan, 20 percent). Life policies in Europe constitute about 40 percent of the total EC market, and nonlife premiums account for the remaining 60 percent. Thus, the life insurance market for the European Community is probably on the order of approximately $89 billion annually in premiums, and the nonlife market (which includes most of the reinsurance market) about $131 billion.

According to 1984 figures, the EC market share of non-European-based insurance companies was 24 percent.[121] (In comparison, non-U.S.-based companies have something less than 10 percent of the U.S. market, and non-Japanese companies have less than 3 percent of the Japanese market). EC insurers, however, hold a very large share of the world reinsurance market, probably in excess of 60 percent, and reinsurance constitutes a significant percentage of international trade in insurance.

Diversion of trade to the U.S. market

Little diversion of trade can be expected as a result of the EC insurance directives simply because of the intense competitiveness of the current U.S. insurance market. The market is served by over 5,000 insurance companies, in which non-U.S.-based companies have long played a role. Several large EC-based primary insurers, for example, have been established in the U.S. direct insurance market for decades. Also, EC-based reinsurers continue to play a role in the United States, and the position of Lloyd's of London in insuring large and unusual risks has long been well known. The United States is also the EC's largest insurance export market. Hence any additional competition that might possibly be diverted to U.S. markets is considered unlikely to have any material impact.

U.S. investment and operating conditions in the EC

Freedom of services.—The two principal insurance directives deal with the freedom to provide services for life and nonlife (e.g., property and casualty) insurance. The manner in which the two principal insurance directives are implemented is likely to determine the degree to which U.S. insurance services can be supplied to the EC. The key issues regarding such implementation are discussed below.[122]

Nonlife insurance.—The European Community has considered the liberalization of nonlife insurance since at least 1964, at which time, for example, national restrictive controls within the EC in the field of reinsurance were removed. Whereas the first insurance directives had largely been effective in providing for the freedom of establishment for life and nonlife insurance, the White Paper set forth the goal of eliminating all barriers to cross-border insurance services. The European Community intended to follow the approach that was taken in the banking and securities area and introduce a single license and home-country control for all insurance services.

However, the European Court of Justice in a decision on December 4, 1986, took a more restrictive approach regarding the liberalization of insurance services.[123] In its decision, the ECJ noted the importance of insurance services to the general welfare and financial security of individuals. The ECJ distinguished between policyholders who were capable of protecting their own interests (i.e., "large risks") and policyholders who were in need of protection (i.e., "mass risks").

On the basis of the ECJ decision, the nonlife directive differentiates between "large" risk and "mass" risk consumers. "Mass" risks are the ordinary individual consumers who need regulatory protection against possible misleading advertising, complicated insurance contracts, claims procedures, and similar complexities of buying insurance. The Second (nonlife) Insurance Directive is trade liberalizing, but only for "large risks." The directive does not liberalize as fully as in the banking and securities sectors, nor does it go as far as was envisioned in the White Paper.

[120] The decline in the exchange rate of the dollar against other major currencies since 1985 exaggerates the total figure when it is expressed in U.S. dollars.
[121] See ch. 29 of *Panorama of EC Industry 1989*.
[122] USITC staff held discussions with EC Commission representatives regarding issues raised by the 1992 insurance directives on Apr. 19, 1989.
[123] Case 220/83, Commission v. France; case 252/83, Commission v. Denmark; case 205/84, Commission v. Germany; and case 206/84, Commission v. Ireland.

Life insurance.—The Second (life) Insurance Directive, which was proposed by the EC Commission in December 1988, is relatively less trade liberalizing. The proposal contains a reciprocity clause modeled closely on that of the Second Banking Directive. Depending on its final interpretation by EC authorities, this could be of considerable concern to U.S. insurers wishing to do business in the EC.

Harmonizing essential insurance requirements in the European Community posed particular difficulties. The life directive would be relatively less liberalizing than the nonlife directive. The directive does not apply to "large risks," and it only applies to certain "mass risk" consumers. Home-member-state control applies when an individual takes the initiative and approaches a life insurance company in another member state to purchase an individual policy. Host-member-state control applies when a firm actively seeks to sell its policies in another member state.

Determining when an individual is "taking the initiative" or when a firm is "actively selling its policies" may be difficult. If a firm wants to sell cross-border services on the basis of home-member—state control, it may not "solicit business" in the host member state and it may not advertise in the host member state. The firm may only publish notices of its address and the types of insurance that it is offering. This rule, which distinguishes between active and passive freedom of services, creates uncertainties and may be difficult to implement.

The advertising criteria, in particular, may be tough to apply. Whether individuals will be able to approach local insurance brokers, or whether local brokers might be able to advertise policies available through them (although underwritten in other EC states) is also unclear. If so, representatives of U.S. firms thought that brokers may have an increasingly important role and that the directive would tend to increase the liberalization of the market. A future directive will apply to companies, industries, groups, and other "large risks" wishing to purchase group policies.

In any case, the proposed Second (life) Insurance Directive provides that the individual who has the knowledge to approach an insurer of another country is sufficiently sophisticated in insurance matters so as not to need the "normal" regulatory protection that his own country's regulatory system otherwise affords him. Most individuals are allegedly in need of such protection.

It is notable that insurance companies throughout the European Community have engaged in a flurry of cross-border acquisitions and mergers since 1986, thought by analysts to reflect a strategic "positioning" for the post-1992 market.

Assuming these insurance directives are implemented and assuming that the reciprocity article of the life insurance directive is not implemented in a way that restricts services offered by third-country companies, U.S. insurance companies operating in the European Community should benefit from the proposed rules to the same degree as other EC- and third-country-based insurers. In the case of the nonlife directive, any U.S. insurer with a presence in at least one EC nation will, along with all other such companies, obtain the advantage of being able to sell insurance to any "large" risk customer throughout the European Community, without needing to obtain authorization from any national regulatory authority other than the one in which it has its head office.

Due to the limited scope of the proposed life insurance directive, liberalization of the market is much narrower. Industry sources speculate that U.S. insurers in the EC are unlikely to take the lead in testing the limits of its provisions regarding the advertising rules. Due to the political sensitivity involved, that initiative will probably be left to European-based insurers.

These sources thought that U.S. companies operating within the EC would wait for the larger market for life insurance to open, hoping that the expected future directive outlining conditions for life insurance purchases by "large" risks (i.e., groups and companies) will be modeled on the nonlife directive, which permits companies with a presence in one EC country to sell throughout the EC, without the authorization and oversight of each individual EC nation's insurance regulatory authority.

U.S. industry response

U.S. insurance industry interest and activity regarding the 1992 insurance directives has been limited. U.S.-based companies already operating in the EC have had opportunities to comment on the proposed new rules through their European trade associations and contacts with the governments and regulatory authorities where they operate. There is a general consensus that no one, either in Europe or in the United States, knows how the proposed directives (especially those in regard to the freedom to provide insurance services) will be interpreted. It is expected that such interpretations will be affected to a considerable extent by political considerations.

In general, although U.S. firms believe that the liberalization of cross-border, nonlife insurance services for "large risks" will create potential opportunities, they are concerned about how the directive will be implemented.[124] U.S.

[124] See written statement of the U.S. Council for International Business submitted to the USITC in conjunction with this study.

firms expect increased competition to prompt consolidation in the industry as firms link up with suitable partners.

The proposed Second (life) Insurance Directive was issued in December 1988, and interested parties have indicated that they have not had time to form views other than to express concern that a reciprocity article is contained in the directive. Speculation as to what that article might mean, and on the practical difficulties in implementing the general thrust of the directive, is also evolving. The main concern of U.S. industry is that this directive, since it is the latest issued on insurance matters, may portend a change of thinking on reciprocity clauses, i.e., that the several other insurance directives dealing with nonlife insurance and ancillary matters might have reciprocity clauses added to them before they are adopted or even after they have been adopted.[125]

Industrial and commercial insurance customers doing business in more than one EC nation (but headquartered anywhere) favor the nonlife directive. They look forward to being able to consolidate their insurance programs among a fewer number of insurers. They would thereby save a great deal of management time, would probably be able to acquire more competitive insurance bids because of the increased size of a company's consolidated insurance transactions, and would generally save money through economies of scale.

Insurance industry sources indicate that, although many large U.S. insurers are generally aware of the 1992 initiative, little formal analysis has yet been done concerning the insurance directives thus far issued by the EC. Two specialist EC-based legal firms (London and Paris) were somewhat more knowledgeable, but stated that it will not be possible to definitively interpret the directives until additional political decisions are made.

Views of interested parties

No formal submissions were received.

Overall Effects

U.S. Exports to the EC

In general, the financial-sector directives may create potential trade opportunities for U.S. firms that provide financial and insurance services in the EC. Because U.S. financial institutions and U.S. insurance companies provide services, there are no tangible exports of products as such. Given the nature of these services, the financial-sector directives would have the most potential to create larger, more diverse EC markets for U.S. financial services firms (e.g., banks, securities firms, mutual funds, and insurance companies) with agencies, branches, or subsidiaries in the EC.

Diversion of Trade to the U.S. Market

The financial-sector directives are likely to expand trading opportunities for non-EC financial services institutions and insurance companies with subsidiaries in the EC; therefore, there is likely to be no diversion of trade to the U.S. market. Japanese financial services firms have generally been unrestricted in entering and operating in the United States and any continued expansion by these firms is likely to be independent of the impact of the investment services, securities, capital movements, and banking directives. On the other hand, if the "reciprocity" provisions operate to effectively exclude Japanese firms from the EC market (i.e., because Japan does not provide access to its market), then it is possible that Japanese financial services firms will increase their activity in the United States.

U.S. Investment and Operating Conditions in the EC

The 1992 program for financial services creates potential challenges and potential opportunities for U.S. firms. One important risk is that U.S. firms may be restricted, either directly or indirectly, from fully and freely participating in the single financial market. Another important risk is the challenge posed by the prospect of EC financial firms becoming more competitive and operating in a larger and more efficient financial and capital market. If, despite these risks, U.S. firms are able to participate on an equal and nondiscriminatory basis in the liberalized and open EC financial market, then U.S. investment and operating conditions in the EC will be enhanced.

The financial-sector directives are, for the most part, likely to encourage U.S. investment in the EC and to enhance operating conditions in the EC for U.S. financial services firms and insurance companies. The banking, investment services, securities, and capital movements directives should expand trading opportunities for U.S. commercial and investment banks, securities firms and mutual funds principally because they provide for the elimination of restrictions on the movement of capital and the overall liberalization of EC financial markets. Whereas the insurance directives are relatively limited in scope, they should enable a U.S. firm with a single license to sell nonlife policies to "large risks" throughout the European Community and to sell life policies to certain individuals.

Representatives of U.S. financial services firms did not believe that all firms would choose to offer all liberalized services in all national

[125] Ibid.

markets, or that individual strategies would necessarily succeed. They noted that the important point is that firms will not be precluded by law from making business decisions to exploit their perceived comparative advantage. Although there will be opportunities, they expected that there will also be greater competition and some consolidation and concentration was expected. If adopted and implemented as envisioned, they expected that the 1992 program should enable all firms, including U.S. firms, to build on their existing expertise and to obtain certain cost advantages and efficiencies from rationalizing their operations.

CHAPTER 6
STANDARDS

CONTENTS

CONTENTS—*Continued*

CONTENTS—*Continued*

Chapter 6

Standards

Introduction

Standards harmonization is a key component of the 1992 program. Knocking down the plethora of regulatory barriers that have insulated the dozen member-state markets from each other will make it possible for EC firms to achieve a greater degree of the interaction and economies of scale, and improve EC firms' ability to effectively compete in the global marketplace. Elimination of standards-related barriers is also key to the EC's goal of eliminating discrimination in public procurement, since restrictive standards have been one of the primary means of tailoring bids in favor of local suppliers.[1] Taken together, these changes account for a significant portion of the overall economic benefits expected from the 1992 program.[2]

Will U.S. suppliers benefit or be harmed by the EC's effort? Answering that question is not an easy task. The standards component of the EC's 1992 program involves dozens of interrelated actions affecting the way purchases will be specified and carried out. Of the 300 or so initiatives originally programmed in the 1985 White Paper, more than half—a total of 175—are standards-related.[3] The stakes for the United States are high; banner U.S. export industries—such as autos, computers, chemicals, telecommunications, medical equipment, and other machinery—may be fundamentally affected by actions taken as part of the 1992 program.[4] These industries alone represented nearly $40 billion in U.S. exports in 1988. In a recent report, the U.S. Department of Commerce's Office of Trade and Investment Analysis estimated that in 1987 21,900 jobs were associated with each $1 billion in U.S. manufactured exports.[5]

Background

There is general consensus that divergent national standards in the EC member states have held back the competitive potential of U.S. suppliers. In practice, these differences mean that U.S. firms may need to supply different products to the 12 separate national markets or abandon some markets altogether. Manufacturers must often make costly modifications to products in order to meet country-specific requirements. Even where standards are similar, lack of mutual recognition of testing and certification between EC member states means that there can be lengthy delays due to the need to repeat tests and receive separate approvals. Furthermore, time-consuming border formalities are necessary to enforce differing animal and plant health controls.[6]

Removal of such barriers, by adoption of unified standards, could prove a boon to U.S. firms able to meet the new standards. Scale economies gained by the acceptability of a single product throughout the EC, and reduced inventory storage costs could provide an immediate, positive boost to these U.S. firms. If such standards are biased against U.S. suppliers, however, the United States could experience an erosion of its competitive position and a drop in actual EC sales levels, as time is lost retooling production lines and securing necessary clearances and approvals. The words of Joan Spero were fairly typical of the views of many U.S. business leaders:[7]

> The plan to create a single internal market will strengthen Europe, and a strong Europe will benefit the United States. . . The

[1] In most major EC countries, public procuring officials are more or less required to use national, as opposed to EC or international, standards when drawing up tender documents. This reference to standards may be more or less strict: legally binding in certain countries although with a derogation procedure (France) or a voluntary practice used systematically (West Germany and the United Kingdom). Florence Nicolas and Jacques Repussard, *Common Standards for Enterprises*, (Luxembourg: the Commission of the European Communities, [1988]), p. 34.

[2] See pt. I, ch. 3.

[3] Of the 114, 76 have to do with veterinary and phytosanitary controls and 99, with standards, testing, and certification of products. For the purpose of the staff analysis, veterinary and phytosanitary regulations are considered "standards," rather than customs formalities. Although such regulations are now enforced at internal EC member-state borders, their harmonization is a "standards issue," generally following the same format as industrial goods.

[4] Major U.S. manufacturing industries that could be fundamentally affected by the 1992 program are defined as the SITC categories for organic chemicals (51); inorganic chemicals (52); dying, tanning, and coloring materials (53); medicinal and pharmaceutical products (54); essential oils and perfume materials and toilet, polishing, and cleansing preparations (55); fertilizers, manufactured (56); explosives and pyrotechnic products (57); artificial resins and plastic materials, and cellulose esters and others (58); chemical materials and products, n.e.s. (59); power-generating machinery and equipment (71); machinery specialized for particular industries

[4]—*Continued*
(72); metalworking machinery (73); general industrial machinery and equipment, n.e.s. and machine parts; n.e.s. (74); office machines and automatic data processing equipment (75); telecommunications and sound recording and reproducing apparatus, and equipment (76); electrical machinery, apparatus and appliances, n.e.s, and electrical parts thereof (77); and road vehicles (78).

[5] Lester A. Davis, Office of Trade and Investment Analysis, U.S. Department of Commerce, *Contribution of Exports to U.S. Employment, 1980-87* (Washington, DC [March 1989]).

[6] According to a statement submitted to the USITC by the United States Council for International Business, elimination of border controls would reduce costs associated with delays in transporting goods from one country to another.

[7] Joan Spero, Senior Vice President at American Express in testimony before House Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade on Apr. 5, 1989, pp. 1 to 2.

plan is also good for U.S. business. It will open up a vast internal market in which we believe we can compete effectively. . . . However, neither the U.S. Government nor U.S. business can afford to let their guard down. We will have to keep the Europeans honest by insisting that the EC not increase protection or enact disciminatory policies under the guise of 1992."

Nevertheless, the sheer magnitude and cross-cutting impact of the EC's efforts has hindered the U.S. response. Strategies for dealing with the EC's proposed changes depend not only on the contents of EC directives themselves, but on the behind-the-scenes work of Europe's regional standardization bodies and testing institutes. Limited access by the U.S. Government and U.S. business to such discussions has fueled fears that a "Fortress Europe" will be built by the imposition of dozens of new, discriminatory technical requirements.[8]

In the words of one U.S. businessperson, "I don't think the Europeans are hell bent on mischief, but in setting up these new rules, mischief comes in to play."[10]

Some U.S. firms appear to be "voting with their feet," investing directly in the EC now in order to ensure that they will be poised to benefit from increased intra-EC trade—even if the new standards impede U.S. exports. One U.S. business representative stated—

> I would say that across a wide range of industries, companies are . . . [pursuing a European presence] right now, either in terms of new investments, new production, rationalizing existing investments, or finding EC-based partners. . . I think that there is a mixture, quite frankly, of both political prudence and economic necessity which is dictating these investments.[10]

What follows is an explanation of what technical trade barriers are, how they are created, and why they persist. Next, the EC's rather complex process of standards harmonization is described. Finally, a preliminary assessment of the impact on the U.S. industry of 114 standards-related directives is presented.

[8] "[N]on EC manufacturers do not have adequate access to the EC standards development process, which is much less open and transparent at this point than those used by ANSI, ASTM or SAE in the United States." Testimony of Christopher Bates, Director, Policy Analysis, Motor and Equipment Manufacturers' Association, before the U.S. International Trade Commission on Apr. 11, 1989, transcript, p. 109.
[9] Dan Neuhauser, Director of Business Planning, Hyster Co., as quoted in the *Wall Street Journal*, Jan. 19, 1989.
[10] Testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers on Apr. 11, 1989, transcript, pp. 91 and 101.

What Are Technical Trade Barriers?

Standards in and of themselves are not generally considered to be trade barriers.[11]

Indeed, industry has always been a leading proponent of standardization as a means to uniformly define and accurately describe products, much as the yardstick facilitates measurement and a single currency facilitates monetary transactions. Properly drafted, standards can serve as a valuable shorthand for referring to products and can contribute to predictability in the environment for both producers and consumers.[12]

However, barriers to trade can be created by the divergence of standards and regulations and the means employed to ensure conformity with them. Moreover, standards may be set unreasonably high or at a very detailed level, making it difficult or impossible for some producers to comply.

Unlike the situation in the United States and Canada, where several hundred organizations publish standards, each in its own field, the European countries have centralized structures. Set up for the most part early in the 20th century, the member states' national standards institutions are in most cases private associations set up by industry to prepare and publish standards. National public authorities in the EC recognize these standards as national standards and give them preference in public procurement specifications and in the application of technical regulations.[13] The extent to which member states have adopted national standards varies considerably. Some countries—notably France (AFNOR), Germany (DIN), and the United Kingdom (BSI)—have highly developed and extensive systems. Their national standards institutions are widely used by firms in other EC countries.[14]

[11] Compliance with a technical regulation is mandatory, and compliance with product standards is voluntary. Both technical regulation and standards are terms referring to a technical specification for a product, which includes any of the following: (a) the specification of the characteristics of a product, including, but not limited to, levels of quality, performance, safety, or dimensions; (b) specifications related to the terminology, symbols, testing and test methods, packaging, or marking or labeling requirements applicable to a product; or, (c) administrative procedures related to the application of (a) or (b).
[12] In his written testimony before the House Committee on Foreign Affairs Subcommittee on International Economic Policy and Trade on Apr. 13, 1989, John Kinn, Vice President of the Electronics Industries Association, stated, "The EIA believes that timely,consensus standards permit an industry to grow in an orderly fashion. Standards accepted by an industry can insure compatibility and reduce development risks for manufacturers. Standards can minimize consumer confusion and expedite the acceptance of a given product. . . . Standards do indeed provide interchangeability, interoperability, and reduce manufacturers' risk."
[13] Nicolas and Repussard, 1988, p. 25.
[14] See Michael Calingaert, *The 1992 Challenge from Europe*, (Washington, D.C.: The National Planning Association, 1988), p. 26.

An exception to this general procedure for standards development in the EC is in the area of agriculture and food products. Most national and EC standards on additives and other food product characteristics are developed within the respective governments (e.g., Agriculture or Health Ministries) and, within the EC, not by the private sector. Such agricultural standards are often made mandatory by passage of national or EC regulations.

Differences in national standards among the EC member states affect not only U.S. access to the EC market, but also trade among EC members. Michael Calingaert reports that one European television manufacturer had to "make seven types of television sets to meet member state national standards, which required 70 engineers to adjust new models to individual country requirements and cost an additional $20 million per year."[15] British chocolate reportedly cannot be sold in some member states because they use a different definition of chocolate. For years, Germany prohibited the sale of beers brewed in other member states because the additives they contained contravened German national "purity" laws.[16] Indeed, the Cecchini report's business survey found technical barriers to be among the most important ones in the eyes of EC business.[17]

There are basically three types of technical trade barriers currently operating in the EC:[18]

- *Differences in voluntary standards or specifications regarding product form, functioning, quality, compatibility, and/or interchangeability.* Such standards are not legally binding and are usually defined by national organizations such as BSI in Britain, DIN in Germany and AFNOR in France. However, these standards often are used by private and public procurement officials in tender documents and sometimes attain the status of de facto requirements in particular countries. Product liability laws in member states and local rules such as building codes may also play a role in perpetuating these barriers. Insurers sometimes require the use of products meeting national standards or charge higher premiums if nonconforming products are used.
- *Incompatible technical regulations.* Standards contained or referenced in regulations are usually legally binding.[19] Such regulations generally are intended to serve the public interest by ensuring public health and safety or by protecting the environment and consumers. Products typically affected include fertilizers, pesticides, cosmetics, medical devices, automobiles, and machinery. When compliance with particular standards is mandatory, the barrier regulations create is straightforward; they make importation illegal if a good does not comply with them.
- *Differences in product testing procedures used to ensure conformity of products with regulations or standards.* These differences often force firms to repeat tests in the importing country, subject their wares to lot-by-lot inspection, and incur extra paperwork and costly delays when seeking approval to bring their goods to market.[20]

At a minimum, such differences frustrate attempts by firms to operate on an EC-wide scaleand discourage business cooperation.[21] Such barriers also increase unit costs—because of the need to undertake separate research, development, approval, marketing, and warehousing—in each member-state market.[22] Standards-related barriers reduce consumer choice in the EC, delay the introduction of new products, and cause higher relative prices for similar products.[23]

The direct and indirect costs to the EC of divergent regulations and standards are substantial—according to one estimate, almost $6 billion in the case of telecommunications, over $1 billion for foodstuffs, and $3 billion for building products.[24] Overall, the costs to EC industry of differing national technical regulations are estimated to average a little under 2 percent of companies' total costs.[25]

[15] Calingaert, 1988. He cites a speech by EC Commission official Matthew Cocks, at The American Chamber of Commerce (United Kingdom) London, June 16, 1988.
[16] Commission of the European Communities, *Europe Without Frontiers: Completing the Internal Market,* February 1988, p. 39.
[17] As cited in Jacques Pelkmans, "A Community Without Technical Barriers?", paper presented at the conference *Europe 1992: Challenge or Opportunity?,* Washington, D.C., Dec. 8, 1988, p. 2.
[18] Groupe MAC, *Technical Barriers in the EC: An Illustration in Six Industries,* vol. 6: *Research on the Cost of Non Europe,* 1988, p. 5.
[19] Guidelines such as Good Manufacturing Practices are not necessarily binding. Many regulations do not actually contain standards.
[20] Groupe MAC, 1988, p. 6.
[21] Commission of the European Communities, *Europe Without Frontiers: Completing the Internal Market,* February 1988, p. 39.
[22] Jacques Pelkmans asserts that, "In the relatively few cases where technical barriers fully insulate a national market, markets tend to be stagnant, innovation absent and competitive spirit low (e.g., gas appliances). If technical barriers gang up with public procurement to support a "national champion," the resulting innovation tends to be very costly (e.g., switching equipment and aircraft) for recuperation on a small national market." Jacques Pelkmans, "A Community Without Technical Barriers?," paper presented at the conference *Europe 1992: Challenge or Opportunity?,* Washington, D.C., Dec. 8, 1988 , pp. 2 to 3.
[23] Groupe MAC, 1988, p. 28.
[24] Calingaert, 1988, p. 26. Estimate from Paolo Cecchini, The European Challenge 1992, (Aldershot, United Kingdom: Wildwood House [1988]), pp. 25 to 26. The Cecchini report is a compilation of results from a series of studies undertaken by consultants hired by the EC Commission on the "Cost of Non-Europe."
[25] Commission of the European Communities, *Europe Without Frontiers: Completing the Internal Market,* February 1988, p. 14.

Why Do Technical Barriers Persist?

In addition to understanding how technical barriers to trade are created, it is useful to identify what functions they serve and the interests they represent. To a large extent differences in national standards reflect divergent approaches by member states to social, environmental, and consumer concerns, as well as diverse regulatory philosophies and historical circumstances. Up to now, each member state has arrived at different answers to questions such as: Must governments prevent quality-related problems, or can the market decide? How are responsibilities for the safe use of products divided between government, employers, consumers, and workers? What is an acceptable environmental risk? How much and what type of information must consumers have before making purchasing decisions?

An example of how such differences affect intra-EC trade is safety requirements on electrical cutting machines. Dangerous moving parts on French machines are completely isolated from the machine worker, so that the worker would be protected, even in the case of gross negligence. In Germany, the philosophy underlying machine design delegates more responsibility to the machine worker; moving parts are designed to minimize risk and are indicated with warning signs, but are not always completely isolated from the operator.[26]

Traditional practices also play a role in perpetuating technical trade barriers. A good example is the custom of right-hand-drive in the British Isles and the Republic of Ireland. It is not illegal to own and operate a vehicle designed for left-hand drive, but a hundred years of road design and consumer habits combine to make it difficult to penetrate the British automobile market with left-hand-drive cars.[27]

Finally, standards policy plays a role in the overall industrial policies of many EC countries. Consultants to the EC have concluded that in some instances European governments use incompatible standards and discriminatory certification procedures to protect industries deemed of strategic importance.[28] Automobiles is a case in point. EC directives exist for 41 out of 44 essential requirements. The three that remain are not significant in and of themselves: weights and sizes, tires, and windshields. However, certain member states are resisting the completion of these directives for fear of losing complete control on the inflow of extra-EC imports, particularly those from Japan.[29]

[26] Groupe MAC, 1988, p. 7.
[27] Groupe MAC, 1988, p. 8.
[28] Ibid.
[29] Ibid

Previous EC Commission Efforts to Harmonize Standards

During the 1960s and 1970s, the EC Commission attempted to eliminate technical barriers through complete harmonization of the specifications contained in national standards and regulations. (These were the days of Euro-beer and Euro-bread.) Under that effort, instituted in 1969, approximately 215 directives were adopted. Although the 215 included some significant measures—such as the 1970 "low voltage" directive with its widespread application in the consumer electronics area—the results were relatively small in the face of the annual establishment of about 5,000 technical standards by national standards bodies.[30]

The approach also proved frustrating, slow, and inadequate to the task, given rapid advances in technology. Years were spent trying to reach agreement on the technical minutiae of a single product or group of products. In the interim, traders were unsure of what standards they ought to comply with. All too often, by the time agreement was reached, either the product or the standard had become obsolete, "a monument to bygone technology, or worse still, a barrier to innovation," in the words of the EC Commission.[31]

Cases Before the European Court of Justice

Several decisions by the European Court of Justice since 1979 have done much to facilitate the removal of technical barriers to trade. In its landmark ruling in the *Cassis de Dijon* case in 1979, concerning the sale in Germany of cassis manufactured in France, the Court confirmed the basic right of free movement of goods within the EC and ruled that a member state could not prohibit the sale of a product lawfully produced and sold in another EC member state even if the product did not comply with domestic standards—thus affording "mutual recognition" to products subject to standards and regulations. The decision was based on article 30 of the Treaty of Rome, which prohibits quantitative restrictions on trade among the member states and measures having equivalent effect. The principle was upheld again in successive Court of Justice rulings. In 1987, the Court outlawed Germany's 16th-century beer purity laws, and in 1988 it ruled against Italy's pasta purity legislation.[32]

However, the principle of mutual recognition breaks down legally and practically concerning each member state's obligation to protect human health, safety, and the environment. Specifically, if one country maintains a different policy on such essential matters, it may prevent the free

[30] Calingaert, 1988, p. 58.
[31] Commission of the European Communities, *Europe Without Frontiers: Completing the Internal Market*, February 1988, p. 40.
[32] Calingaert, 1988, pp. 17 to 18.

circulation of goods from other member states. This right is guaranteed by article 36 of the Treaty of Rome.[33] (Abuses of article 36 do occur, however. Alleged concern for consumer protection has been the rationale behind several trade-restricting practices, including the outlawed import prohibitions addressed in the two Court cases just mentioned, German beer and Italian pasta, and in a recent ruling against a West German prohibition of imports of sausage containing soy protein.) In instances when countries differ as to how to protect essential public needs, the only way to eliminate technical barriers, short of lengthy and costly Court of Justice litigation, is to adopt a harmonized set of regulations.[34]

Furthermore, support for the 1992 program hinges, in some sense, on perceptions of fairness and equal treatment.[35] If workers are to accept completely free movement of goods and the inevitable dislocation that this implies, they must be assured that social dumping, in the form of differing levels of safety and workplace environment standards, will not occur.[36] Moreover, the Single European Act requires the EC Commission to base its proposals for environmental standards on a "high level of protection." Therefore, EC standards policy endeavors to ensure that the public policy goals of safeguarding human life, protecting animal and plant health, preventing ecological damage, and protecting consumers from fraudulent claims or defective products are fully and reliably met.[37]

[33] Art. 36 specifies exceptions to the general prohibition in the fields of health, safety, consumer protection (recognized as being implied in the article), and environment, as well as rare instances of, for example, issues of public morality. Groupe MAC, 1988, p. 9.
[34] Groupe MAC, 1988, p. 8.
[35] For example, Michael Calingaert reports that some business interests are concerned that their potential benefit from the 1992 program could be undermined to the extent that "the EC will be willing to ease the burden of transition by such actions as public procurement preferences and derogations from the EC regulations." Calingaert, 1988, p. 69.
[36] "Workers in countries in which unions have succeeded in winning relatively high wages, safe workplaces, generous social programs (unemployment compensation, training, pensions, etc.) and an extensive role for workers in corporate decision making are concerned that employers will shift their jobs to countries that have made considerably less progress toward these goals. Such a shift could drive down labor standards and protections where they have been raised and prevent improvements where standards are low." Formal submission for the record by the United Auto Workers to the U.S. International Trade Commission, Apr. 26, 1989.
[37] In p. 8 of its June 1985 White Paper, the EC Commission states, ". . . As far as social aspects are concerned, the Commission will pursue the dialogue with governments and social partners to ensure that the opportunities afforded by completion of the Internal Market will be accompanied by appropriate measures aimed at fulfilling the Community's employment and social security objectives." On May 17, 1989, the EC Commission adopted a provisional draft of a Community Charter of fundamental social rights, including, for example, workplace safety.

Anticipated Changes

The "new approach" proposed in the 1985 White Paper is based on two guiding principles: mutual recognition of existing standards where possible, and harmonization in those exceptional cases where there are legitimate but conflicting views on essential public policy matters among the member states.[38] The approach also implies a different orientation of EC harmonization efforts—away from the time-consuming development of so-called "vertical" standards (i.e., standards developed on a product-by-product basis) and toward simpler "horizontal" standards (which define broad features that whole categories of products are to have).[39] In practice, this new approach should increase the speed and flexibility of the EC Commission in reducing technical trade barriers.[40]

The White Paper lists as priority areas for action the sectors of foodstuffs, information technology and telecommunications, and construction and building products. It envisions introduction of "framework" or "horizontal" directives for broad categories of products, including industrial machinery, pressure vessels, and building materials, mainly setting forth safety requirements. Finally, it proposes a series of directives for specific products, including motor vehicles, tractors and agricultural machines, processed food, pharmaceuticals, chemicals, construction products, and miscellaneous manufactures (e.g., household appliances, toys, measuring instruments, and personal protective devices).[41]

The "New Approach" to Technical Trade Barriers

The EC Commission's proposed approach has the following main elements:

- Increased mutual recognition of voluntary standards. In noncritical areas, i.e., for "voluntary" standards not related to essential issues of public health and safety, the EC will require member states to allow goods produced in other member states in accordance with their national standards to be sold freely in other EC markets without being modified, tested, certified, or renamed.[42]
- Harmonization of "essential" standards. Generally these are related to public health and safety or consumer and environmental

[38] Statement of Mr. John Farnell, Commission of the European Communities, Directorate General for Internal Market and Industry Affairs to the U.S. Chamber of Commerce, Washington, D.C., Apr. 27, 1989.
[39] Groupe MAC, 1988, p. 10.
[40] Ibid.
[41] Commission of the European Communities, *Completing the Internal Market: White Paper from the Commission to the European Council*, June 1985, annex, pp. 14 to 21.
[42] Commission of the European Communities, *Europe Without Frontiers: Completing the Internal Market*, February 1988, p. 42.

protection, such as toy flammability or auto emission standards. However, EC-wide mandatory standards will also be developed when there are compelling commercial reasons for doing so, for example in telecommunications, information technology, and other high-technology areas, such as biotechnology.[43]

Harmonization legislation will, however, only lay down mandatory requirements in the form of general levels or standards of protection. In place of detailed specifications, "new approach" directives include references to European standards as a favored means of proving con- formity.

Thus, harmonization is being done in two steps:

1. *Spelling out the essential requirements that products must meet in EC Directives or Regulations*. Products meeting these essential requirements can be freely sold throughout the EC; those that do not are effectively banned.
2. *Development of detailed specifications* or standards sufficient to ensure that products meet essential requirements. This task has generally been delegated by the EC Commission to the private European regional standards-making bodies. Conformity with these European standards will be considered presumptive proof that a product fulfills the essential requirements laid out in EC directives. However, compliance with these standards is not mandatory. As a result, suppliers, in theory, should be permitted to freely market innovative products, so long as suppliers prove conformity with the directives' essential requirements.

- *Streamlining testing and certification* procedures, in part by adoption of EC-wide standards for good laboratory and manufacturing practices and in part through enhanced mutual recognition of test data and certification marks among member states.
- *Preventing new technical barriers from arising,* on the basis of an expanded version of the so-called "mutual information" directive (83/189). An EC-wide information procedure on all draft and final national standards in member states was introduced in 1983. It provides the EC Commission and member states with information on standards-drafting activities by national standards institutes in the member states, permits member states to comment on other members' draft standards, and empowers the EC Commission to impose a 1-year standstill on such activities if the standard in question is trade discriminatory or would be better achieved at the EC level. On January 1, 1989, the system was extended to agricultural products, foodstuffs, pharmaceuticals, and cosmetics.

[43] According to the EC Commission, this is a case "where inter operability of equipment is necessary for the rational development of new products and the maintenance of both free competition and any significant freedom of consumer choice," thus, "fairly comprehensive mandatory Community harmonization may still be appropriate." Commission of the *European Communities, Europe Without Frontiers: Completing the Internal Market*, February 1988, p. 42.

The Role of Regional Standards Bodies[44]

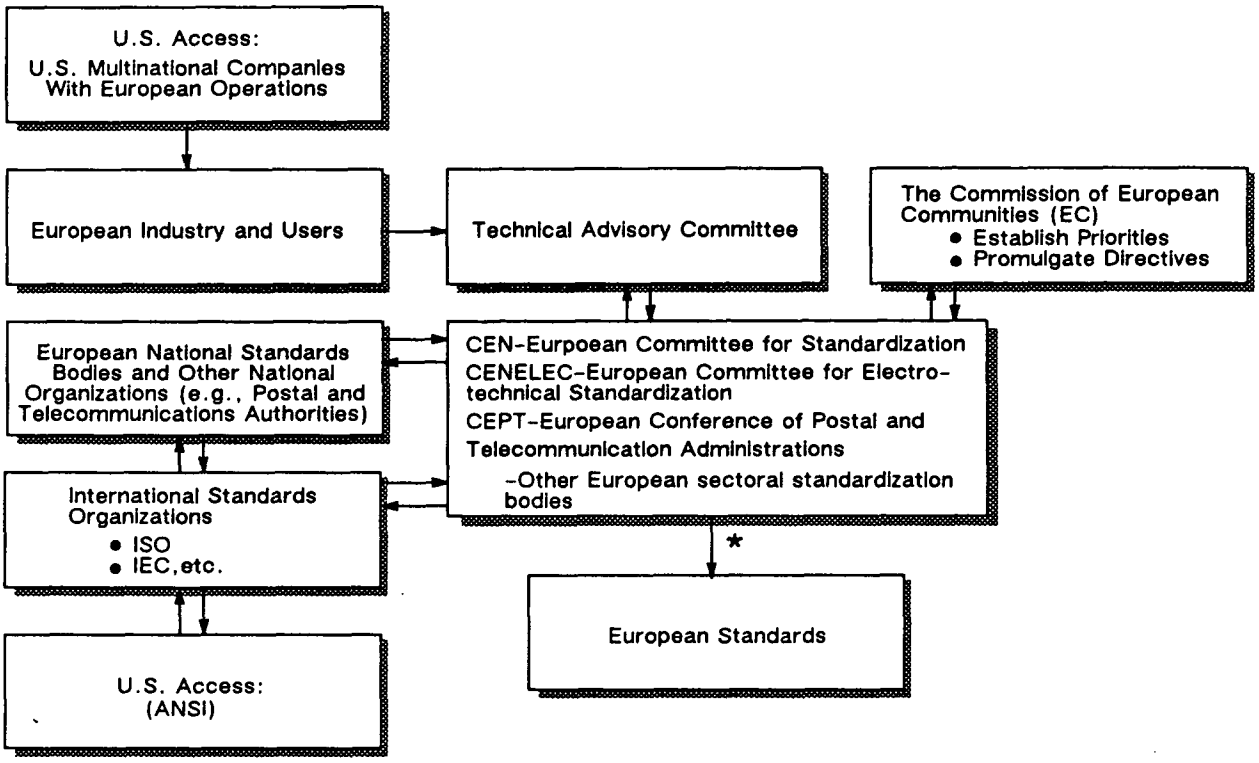
The task of establishing European technical standards for products will in most cases be delegated to European standardization bodies such as CEN, CENELEC, and ETSI.

- CEN, or the European Committee for Standardization, promotes European regional standardization in the nonelectrotechnical field. CEN is the world's largest regional standards group. It is composed of European member bodies within the EC and the European Free Trade Association countries (EFTA).
- CENELEC, the European Committee for Electrotechnical Standardization, promotes European standardization in the electrotechnical field. Its membership is basically the same as CEN's.
- ETSI, the European Telecommunications Standards Institute, created by the European Conference of Post and Telecommunications Administrations (CEPT) in 1988 specifically to develop standards related to telecommunications, information technology, and broadcasting.[45] Private firms, including some subsidiaries of major U.S. firms, participate directly in ETSI's activities, and foreign observers are allowed in some circumstances.

These bodies draft standards through a fairly complex process involving the interaction of European technical experts, producers, users, and policymakers operating through their national standards organizations. Much of the work is handled by their 198 technical committees. A flowchart of this process is contained in fig. 6-1. The European organizations are supposed to base their work as much as possible on relevant international standards. When an EC standard is agreed upon, it will then have legal weight in all member states. Specifically, the resulting standards will be published in one of four forms,[46] with the differences essentially in the degree of obligation on the members.

[44] Much of this material is derived from a paper by Patrick W. Cooke entitled "A Summary of the New European Community Approach to Standards Development," U.S. Department of Commerce, National Institute of Standards and Technology, August 1988.
[45] In cooperation with the European Broadcasting Union.
[46] EN or European Norms: ENs must be implemented at the national level by being given the status of a

Figure 6-1
Diagram depicting interrelationships of entities influencing the development of European standards



*Draft European Standards (CEN/CENELEC) issued for "Preliminary Vote" are listed in ANSI's STANDARDS ACTION to allow U.S. interests an opportunity to obtain information and provide comments (through ANSI). (STANDARDS ACTION is published biweekly by the American National Standards Institute, 1430 Broadway, New York, NY, 10018.)

The EC and its member states are now setting standardization priorities. The regional standards organizations will, as a function of these priorities, generate European standards in consultation with the national standardization organizations. In some cases new technical committees have been established to facilitate the process.

Important exceptions to the use of private standards bodies for drafting technical specifications are the areas of agriculture (e.g., food products and phytosanitary controls) and chemicals. Rather than rely on private organizations, the EC Commission has been delegated responsibility for implementing essential requirements. Currently, it develops such standards internally, in consultation with member-state health authorities, and proposes them as actual directives or regulations. However, the process of issuing such rules has been slow, and the harmonization of EC standards for agriculture and chemicals remains incomplete. In the case of additives, however, the Council has reserved the right not only to adopt new lists of approved additives but also to administer the EC system, which will entail the adoption of several thousand separate decisions. In two cases of limited amendments to the directives on "colorings" and

[48]—*Continued*
national standard and by the withdrawal of any conflicting national standard. EN implies that the identical text is applicable in all EC member states.
HD or Harmonization Document: The HD must be implemented at the national level either by the issue of acorresponding national standard or, at a minimum, by the public announcement of the HD and title, and in both cases no conflicting national standard may continue to exist. However, the HD also allows national deviations under special conditions: to allow for a national legal or regulatory obligation or to allow for a technical problem.
ENV or European Prestandard: ENV may be established as prospective standards for provisional application in technical fields in which the innovation

[48]—*Continued*
rate is high or in which there is an urgent need for guidance. Members are required to make the ENV available at the national level in an appropriate form and to announce their existence in the same way as EN/HD. However, any conflicting national standards may be kept in force until such time as the ENV is converted into an EN.
ETS or NETs: Standards approved by ETSI will be known as ETS or European Telecommunications Standards. I ETS is the designation for interim standards approved by ETSI. NETs, or Normes Europeanees Telecommunications, are approved by CEPT.

"preservatives," the Council has not been able to reach a common position.[47]

Testing and Certification

Confidence of consumers and businesses in the quality, safety, and efficacy of products from suppliers in other EC member states will be crucial to achieving the EC's goal of a single, integrated market.[48] If there is reason to doubt that foreign suppliers meet minimum standards of safety and performance, that foreign foods are healthy, or that foreign test results are reliable, discrimination against nonnational suppliers may well continue. EC policy towards testing and certification of conformity with standards will thus play a key role in the overall success of its effort to eliminate technical barriers to trade. Furthermore, movement towards less detailed, more performance-oriented EC directives implies a greater role for testing and certification to ensure that products meet the essential requirements.

A fundamental argument for testing and certification in the first place is to redress the asymmetry in information between producers and consumers. This informative function gets diluted if certification itself is not subject to minimum quality and objectivity rules or if there are many certification marks without the guarantee that they provide comparable information.[49] With a few exceptions, mutual recognition of certification does not currently exist in the EC, thus forcing the costly and time-consuming repetition of tests and approvals. A more coherent approach to testing and certification across the EC should improve the confidence of consumers and end users in products, should enhance predictability and ease paperwork for manufacturers, and should make it easier for the EC Commission to ensure that products placed on the European market meet minimum safety requirements.

The outlines of EC policy on this issue are still unclear. In late 1988, the EC Commission released a draft paper presenting a detailed proposal for an EC-wide policy on testing and certification for manufactured goods. A formal EC Commission proposal for a Council decision in the area of testing and certification was released on July 5. At press time for this report only a 9-page summary of the Commission's formal 96-page proposal was available. The discussion below is based upon both the draft statement and the summary. [50]

EC policy will apparently employ a "modular approach" to testing and certification, differentiating between voluntary and regulated areas. Specifically, the EC's proposed policy aims (1) to organize the legislative mechanisms for conformity assessment of products subject to EC regulation and (2) to set the ground rules for such activities in the private sector. It does so by proposing the introduction of uniform mechanisms for the formal evaluation of testing laboratories and certification bodies in the member states.

Regulated areas

In areas covered by EC directives, the EC will require mutual recognition of test results generated by bodies meeting specified criteria. The EC Commission had already requested CEN and CENELEC to adopt a series of European standards for testing laboratories and inspection and certification bodies. These standards are spelled out in the EN 45000 series, which set the criteria that will be used to ensure the competence of such bodies to assess conformity with EC regulations and define the means to be used to assess conformity with such criteria. They are based on relevant ISO/IEC guides and ILAC documentation.

The EC also aims to increase flexibility by offering manufacturers, whenever possible, a choice of certification methods, for purposes of demonstrating conformity with EC regulations.

- Generally speaking, producers that manufacture their products in accordance with European standards—i.e., those developed by CEN, CENELEC, or ETSI—will be able to self-certify that these products meet the essential requirements of EC directives.
- Those that do not must receive third-party certification from member-state testing bodies of which the EC has been notified and that operate in accordance with CEN/CENELEC guidelines. The EC's recent proposal states that member states are permitted to notify only those bodies that can demonstrate conformity with the EN 45000 series when notifying the EC Commission of the bodies responsible for implementing EC directives. Should the bodies in question not be formally accredited, the national authorities will have to produce documentary evidence of such conformity.
- Certain types of products, such as medical devices, will be subject to more stringent requirements. In those cases, the manufacturer may have to either (1) register its quality assurance

[47] See, for example, Commission of the European Communities, *Fourth Progress Report of the Commission to the Council and the European Parliament Concerning Implementation of the Commission's White Paper on the Completion of the Internal Market, COM* (89)311, (Brussels, June 20, 1989) par. 58.
[48] Ibid., pars. 34 and 38
[49] Jacques Pelkmans, "A Community Without Technical Barriers?" Paper presented at the conference *Europe 1992: Challenge or Opportunity?*, Washington, D.C., Dec. 8, 1988, p. 2

[50] The nine-page summary of the proposed policy is entitled "Mutual Recognition of Tests and Certificates: the Global Approach," and was issued by the EC Commission on July 5, 1989.

program,[51] which would come under surveillance by a "notified body," or (2) obtain premarketing type-approval of the product from a "notified body." Such procedures will be restricted to products whose use presents substantial risks to human health and safety.[52]

The specific combination of procedures that manufacturers will be permitted to employ to demonstrate conformity with essential requirements will be set out in each directive. Manufacturers will then be free to choose among the recognized procedures.

The EC Commission reiterated its intention to uphold its international commitments under the GATT and the Standards Code by ensuring that products originating in third countries are granted access to certification systems in the EC (both voluntary and mandatory) on the same basis as products originating in the European Community. Third-country products may only be denied certification for the same reasons products originating inside the EC can—namely, nonconformance with standards and lack of safety. Third-country suppliers will be given the same choices of means to demonstrate conformity with EC directives as those given to EC suppliers, including manufacturers' declarations of conformity (self-certification). "Notified" testing and certification bodies are required to treat non-EC suppliers in a nondiscriminatory fashion. The EC will also fund the creation of a European data base containing information on products that are legally required to be certified, by whom, how, and by what procedures. The data base will also contain information on relevant ("notified") third-party certification bodies. It is unclear whether non-European firms will have access to the new data base, dubbed CERTIFICAT.

Although the same testing and certification procedures will apply to European and U.S. producers, the system as it is now proposed may cause more difficulties for U.S. suppliers, since they may be forced to have their products tested in Europe by "notified bodies." The EC Commission indicated that acceptance of test reports and certificates from foreign testing laboratories and certification bodies pertaining to any product subject to national or EC-level regulations would hinge on negotiations with the foreign government to achieve that end.

Such agreements would apparently have to be negotiated with the EC as a bloc and may be difficult to conclude. The EC Commission may require that the third country recognize all of the notifiedbodies on its list as a condition for such agreements.[53]Priority will be placed on conclusion of agreements in areas wherein EC directives have already been adopted by the Council, such as pressure vessels, toys, building materials, and machinery. If mutual recognition agreements between the individual member states and third countries already exist, and the products in question are not subject to EC-wide standards directives, there will be a gradual move towards transforming the bilateral agreements into EC-wide agreements. If an EC-wide regulation has been established, however, such bilateral agreements would become null and void.

The EC Commission stated that the EC would be ready to begin such negotiations after the Council of Ministers approves the proposed decision and that such negotiations will have as their starting point the premise that the EC is bound to guarantee the level of protection on its market set forth in EC Commission directives. Technical competence of foreign testing laboratories, and inspection and certification bodies will be determined on the basis of conformity with the EN 45000 and 29000 series of standards.

Manufacturers' declarations of conformity are likely to be permitted in areas where recognized quality assurance programs of individual manufacturers have been evaluated and accepted("registered").[54] This requirement may pose a problem for U.S. suppliers, since the United States does not have in place such a registration system. The American Society of Quality Control is reportedly in the process of developing such a registration system, however.

Unregulated areas

In the areas in which no directives apply, mutual recognition of testing and certification will be encouraged but left up to the private sector. The EC Commission's philosophy reportedly is that mutual confidence is best developed by accreditation and self-policing rather than by EC

[51] Quality assurance programs must comply with CEN/CENELEC's standards for quality assurance, the EN 29000, in order to be "recognized" within the European Community. These standards reportedly are based on the ISO 9000 series of standards. Because CEN and CENELEC oblige their member bodies to withdraw national standards for quality assurance that diverge from the EN 29000, standards for quality assurance will be harmonized throughout Europe.
[52] Informal communication from the U.S. Department of Commerce, Office of European Community Affairs, May 10, 1989.

[53] Testimony by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers before the U.S. International Trade Commission on Apr. 11, 1989, transcript, p. 86.
[54] Statement of Mr. John Farnell, Commission of the European Communities, Directorate General for Internal Market and Industry Affairs to the U.S. Chamber of Commerce, Washington, D.C., Apr. 27, 1989.

legislation.[55] The EC Commission will encourage testing laboratories and inspection and certification bodies in the EC to follow the EN 45000 standards and, when necessary, to use third-party assessments to demonstrate conformity. The EC Commission will also encourage member-state accreditation of laboratories and certification bodies. Accreditation is to entail a third-party evaluation of the testing laboratories exclusively on the basis of the relevant EN standards.

The EC Commission also proposes creation of a central organization to coordinate activities by the private sector related to testing and certification. This organization would not assess products itself, but rather would serve as a mechanism for bringing together all interested parties—consumers, users, public authorities, testing laboratories, certification bodies, etc.—for purposes of establishing basic principles of competence, openness, and transparency. The organization will both facilitate the negotiation of mutual recognition agreements among the member states and ensure that the basic principles set forth above are safeguarded in such negotiations.

Agriculture and food products

In the area of agriculture and food products, member states currently have different inspection and enforcement mechanisms. As part of the 1992 program, the EC Commission is considering an interim regime for the harmonization of national licensing of food producers. This is an urgent matter; officials of some private firms and member-state governments have expressed concern that certain member states suffer from lax enforcement of food-inspection laws. They fear that unsafe products imported into the EC through these states have the potential to endanger consumers throughout the EC.

An EC-wide system of food inspection and approval is necessary to provide consistency across the EC and to create a strong image of official approval of food safety. Several such systems are said to be considered. For instance, food-product standards could be developed by a private body yet to be formed. However, this idea has not found wide support within the EC Commission because, among other things, an industry-linked private standards body might lose credibility in the eyes of consumers.

Other suggestions include a quasi-independent EC agency modeled after the U.S. Food and Drug Administration (FDA). Some EC officials see this as impossible; such a body would need rulemaking powers that the EC Constitution doesn't currently provide. Alternatively, the EC could adopt existing international food-product standards, such as those specified in the GATT orthe *Codex Alimentarius* (a joint project of the World Health Organization and the United Nations Food and Agriculture Organization). This move would probably result in fewer complaints by third-country exporters, particularly those from signatory countries of the GATT or the UN.

Progress to Date

The EC has made considerable progress in the standards component of the 1992 program. As of December 31, 1988, the Council had reached agreement on a total of 108 directives, 70 percent of which relate to standards.[56] Although overall progress has been fairly rapid, proposals on veterinary and phytosanitary controls have lagged behind schedule.

The EC Commission reports that, as of yearend 1988, the major framework directives on pressure vessels, toys, construction materials, and electromagnetic compatibility had been adopted or were close to being adopted. The Council was reviewing proposals on machine safety and personal protective devices. Harmonization of regulations for chemicals and tractors was completed.[57] Accomplishments include two environmental measures harmonizing emission controls on large passenger cars and on commercial vehicles, agreement on standards for cellular telephones, and completion of work on a package of measures relating to high-technology medicinal products.[58]

The most important measure brought under consideration in 1988 was the machine safety directive, reportedly covering several thousand types of industrial machines. The proposed directive includes safety requirements and provides for specific standards to be developed over the next 2 years by CEN and CENELEC, with mutual recognition governing until then.[59] The EC Commission reports that work was well under way as of December 31, 1988.[60]

Progress on harmonization of technical requirements in the EC hinges upon the ability of the regional standardsmaking bodies to develop technical specifications. However, progress in this area is difficult to gauge. The EC Commission reports that mandates have been given to CEN and CENELEC in connection with directives on machine safety, personal protective equipment, electromagnetic compatibility, construction materials, and pressure vessels. The U.S. Government is in the process of obtaining the

[55] Statement of Mr. John Farnell, Commission of the European Communities, Directorate General for Internal Market and Industry Affairs to the U.S. Chamber of Commerce, Washington, D.C., Apr. 27, 1989.

[56] *Completing the Internal Market: An Area Without Internal Frontiers,* the progress report required by art. 8B of the treaty, COM (88) 650 (Brussels: EC Commission [1988]). The report covers the period through November 1988.
[57] Ibid.
[58] Calingaert, 1988 , p. 59.
[59] Calingaert, 1988 , p. 60.
[60] *Completing the Internal Market: An Area Without Internal Frontiers,* the progress report required by art. 8B of the treaty, COM (88) 650 (Brussels: EC Commission [1988]), p. 10. The report covers the period through November 1988.

future work programs for CEN and CENELEC. ETSI has developed European telecommunications standards on approval requirements for data terminal equipment for connection to circuit-switched public data networks, leased circuits, and the Integrated Services Digital Network (ISDN). ETSI intends to draft technical specifications or NETs for cellular phones, modems, telecopiers, and teletext machines in the near future.[61]

Such progress also depends on the effective incorporation of the the relevant EC texts into national legislation in the member states. Progress on this front has been slow, however; only 2 of the 60 1992-related measures slated to go into effect by June 1989 have been incorporated into national legislation in every member state to date. The Toy Safety Directive, slated for member-state implementation by July 1, 1989, has yet to be incorporated into national law by any member state.[62]

Despite overall progress, some technical barriers are likely to remain. Article 100A of the Single European Act permits a member state, despite adoption of a harmonization measure on the basis of weighted majority, to impose its own (presumably more stringent) national standards on the grounds of "major needs," such as protection of health or the environment, as long as the EC Commission confirms that the measure is not a disguised restriction on trade. Denmark has invoked this provision in connection with automobile emission standards, and other member states reportedly may do likewise.[63]

Possible Effects

In the analysis of the potential impact on the United States, all directives proposed by December 31, 1988, that were considered standards related were reviewed. The number of U.S. products potentially affected by these directives is enormous. Included among these directives are several "framework" directives: the machine safety directive reportedly affects hundreds of products, covering at least half of all the machinery sold in Europe, and those directives related to construction materials, materials in contact with food, and simple pressure vessels are quite broad in scope. On the basis of this analysis a tentative breakdown by industry of the standards-related directives was made, which is presented below along with brief comments.

The overall impact of the directives—including their effect on U.S. exports, imports, and investment in the EC—is discussed next. Finally, detailed writeups on 12 directives or related groups of directives are presented. These directives were chosen because they illustrate some of the major issues identified as possible sources of concern for U.S. industry and because of the assessment of their potential impact on U.S. exports and investment in the EC.

Several points regarding the assessment of impact should be emphasized. Many of the directives are crafted in general terms. This is apparently by design, since the directives are meant to set forth in principle the desired features of the class of products in question, thus leaving technical experts in the European standardsmaking bodies, CEN and CENELEC to describe the actual scope of coverage, the technical means of achieving the "essential requirements" set forth, and the mechanisms by which products will be judged to be in conformity.

Also, a number of directives are not yet final. The content of a particular directive may change as it makes its way through the EC decisionmaking process, and with it, the potential effect on U.S. firms. Third, even when directives have been finally adopted, much remains to be done—notably, the drafting of technical specifications and development of testing and certification procedures. Barriers to non-EC suppliers may well be introduced at that time. Concerns exist over possible attempts by one or another country with a highly developed standards system to impose that system on the rest of the EC as part of this process.[64] These attempts could lead to "standardizing up"—i.e., the imposition of more detailed, stringent standards across the entire EC market.[65] Germans, drawing upon the comprehensive and widely used DIN system, reportedly chair approximately 30 percent of the technical committees of CEN and CENELEC.

Finally, U.S. industry appears to be at various stages of preparation for dealing with the standards-related changes the 1992 program will bring. As a general rule, large, multinational firms are well aware of the changes that will have an impact on their businesses, they have direct investments in the EC, and they are better placed to influence (with varying degrees of success) the decisionmaking process and to exploit the

[61] ETSI, "Programme de travail Concernant Les Normes NET."
[62] Commission of the European Communities, *Fourth Progress Report of the Commission to the Council and the European Parliament Concerning Implementation of the Commission's White Paper on the Completion of the Internal Market*, COM (89) 311 (Brussels, June 20, 1989) pars. 14 and 51.
[63] Calingaert, 1988, p. 60. art. 100A, par. 4: "If, after the adoption of a harmonization measure by the Council acting by a qualified majority, a Member State deems it necessary to apply national provisions on

[63]—*Continued*
grounds of major needs referred to in Article 36, it shall notify the Commission of these provisions."
[64] Calingaert, 1988 , p. 60.
[65] In its Apr. 25, 1989, submission to the U.S. International Trade Commission, the United States Council for International Business stated, "U.S. companies would be concerned if "harmonization" at the EC level resulted in greater, rather than less, regulation, and if measures were adopted or implemented that discriminated against firms of non EC origin investing in or exporting to the Community."

potential for economies of scale and reduced costs possible in a unified internal market. Highly regulated industries, such as pharmaceuticals and chemicals, also appear to be more "geared up." Small and medium-sized firms rely more on direct exports, are less likely to be familiar with directives in their product area or to have completed their assessment of them, and are less able to influence the standardsmaking process in the EC.

Virtually all U.S. firms and Government observers expressed strong concerns about the lack of transparency of the activities of regional standardsmaking bodies and the difficulty of influencing draft standards. The words of the National Association of Manufacturers' Stephen Cooney were fairly typical:[66]

> "Right now, they claim that they inform ANSI of all standards up for formal adoption, but, by that point in the process is too far along. Basically it's too late. The deals have already been made, and it's very hard to change those deals."

In an opening statement on May 10, 1989, at a hearing held by the House Subcommittee on International Economic Policy and Trade to discuss the administration's strategy for dealing with 1992, Representative Sam Gejdenson stated that[67]—

> "Witnesses have testified that the Administration must continue its efforts to open up the EC-92 standards setting process, which is closed to U.S. firms until the last moment. The lack of transparency in the European process contrasts sharply with the openness of the U.S. system, in which European firms participate at all stages. Witnesses testified that U.S. business could be much less competitive in Europe after 1992 if product standards were written to benefit European business and were released to U.S. firms many months after they were already given to European firms."

Access in the area of agriculture and food products may be somewhat better. Representatives of EC- and U.S.-based firms and trade associations in the agriculture and food-product industry interviewed by USITC staff indicated that they typically gain access to the standards-development process by lobbying EC working groups involved in the preliminary stages of standards development and member-state representatives to the Council involved in the latter stages of EC approval of directives or regulations.[68]

An agreement reached between U.S. Secretary of Commerce Robert Mosbacher and Martin Bangemann, EC Vice President for Internal Market and Industrial Affairs, may improve somewhat U.S. access in the area of manufactured-goods standards. The two agreed that the EC's process of standards-setting should be "clear enough that businesses in countries outside the EC are able to understand and comment on proposed requirements." The two leaders also agreed that testing and certification procedures should be open and transparent and that imported products would have the same access to certification procedures as would domestic products. They also agreed that it would be appropriate to initiate discussions regarding the mutual recognition of tests and certificates of conformity once the Council of Ministers adopts an overall EC policy and testing certification. Furthermore, Mr. Bangemann committed the EC to formally discuss U.S. concerns about the standards-related aspects of the EC's 1992 program at a meeting between the United States and the European Community slated for this summer.[69]

Sectoral Breakdown

Directives were categorized on the basis of an assessment of the industry sector most likely to be affected. However, some directives will have a direct or indirect impact on other industries. For example, directives on food additives may primarily affect the agriculture and processed food industries. However, such directives will also have a direct impact on the chemical industry. The recent U.S.-EC dispute over hormones in meat illustrates this point. The complaining party in the United States was the meat industry, but obviously U.S. producers of hormones could be affected if U.S. meat producers reduce purchases of hormones. Though not exhaustive, the listing gives a sense of the types of U.S. industries most affected by standards-related directives in the 1992 program.

U.S. Exports to the EC

Third countries have a substantial stake in the outcome of the EC Commission's standards-related work.[70] In some areas, U.S. firms could be harmed by some of the EC's proposed

[66] Testimony before the U.S. International Trade Commission by Stephen Cooney, International Investment and Finance Director of the National Association of Manufacturers on Apr. 11, 1989, transcript, p. 99.
[67] Opening Statement of Representative Sam Gejdenson, Chairman, Subcommittee on International Economic Policy and Trade of the House Committee on Foreign Affairs, May 10, 1989. pp. 2 to 3.
[68] USITC staff meetings in the EC with American Soybean Association; Federation de l'Industrie de l'Huilerie de la CEE; Commission des Industries Agricole et Alimentaire de l'Union des Industries de la CEE; the M&M/Mars Co.; Waren Verein der Hamburger Borse e.V.; Southern Pine Marketing Council & Western Wood Products Association; and American Plywood Association, Apr. 17 to May 4, 1989.
[69] *U.S. Department of Commerce News*, No. G 89-14 (May 31, 1989).
[70] In testimony by Stephen Cooney of the National Association of Manufacturers on Feb. 9, 1989,

Table 6-1
Sectoral breakdown of standards-related directives

Industry	*No. of directives*	*Staff comment*
Agriculture	65	The largest number relate to disease control and health problems in trade in fresh meat and produce. A number appear to have little or no impact, either because the United States already meets or exceeds the proposed standard, because it merely codifies existing practice, or because there is little or no U.S.-EC trade in these products (e.g., cereals, milk, infant formula). Some directives, such as those on swine fever, appear to regulate only procedures in or between member states.
Chemicals	5	Pesticides, fertilizers, cosmetics, and detergents are areas most directly affected. There is a direct linkage to the agriculture category in some cases, i.e., food additives and medicated-feedingstuffs. The industry is also affected by directives on labeling of dangerous preparations.
Pharma-ceuticals	9	These directives basically incorporate existing practices of the member states into EC law and are generally supported by U.S. industry. The most important piece of legislation according to the U.S. industry is a yet-to-be-proposed directive for a single-market authorization procedure. At present, every member state maintains a national authority for the licensing of medicines and making reimbursement decisions. A single marketing authorization that is acceptable throughout the EC is the goal of the EC Commission. Two alternatives to accomplish the goal are under active consideration: the mutual recognition of marketing authorizations between member states or the establishment of a "supranational" regulatory body like the FDA. U.S. industry is also concerned about future pricing of products, particularly in regard to transfer pricing and "target profits," and about the definition of high-technology drugs.
Machinery	7	Most of these directives concern safety. Also included are very far-reaching "framework" directives, such as those on machinery safety and simple pressure vessels. Important products affected by separate directives include lawnmowers, excavators, forklift trucks, and household appliances. U.S. exports of the machines in question are estimated at more than $5 billion. One directive has no impact; the United States does not produce tower cranes.
Motor vehicles ..	22	These directives present a series of mostly small changes intended to make possible the "type approval" of cars within the EC. The staff reports mostly positive comments from industry regarding streamlining of procedures and harmonization of standards. In May 1989, the EC Commission proposed stricter standards for small-car exhaust emissions and stated its intention to propose new emission standards for midrange and larger engine cars. Its objective reportedly is to make auto-emission standards as strict as those in the United States by January 1, 1993.[1] Moreover, the EC Commission has announced its intention to submit proposals on commercial and heavy-goods vecicles in 1990.[2] Adoption of stricter emission standards, if comparable to those in the United States, could benefit U.S. suppliers of auto parts.[3] Testing and certification may be an issue, however.
Telecommu-nications ...	8	These directives constitute part of an overall EC policy on the telecommunications sector, including equipment and services. In line with the so-called "Green Paper on the Development of the Common Market for Telecommunications Services and Equipment," all but the basic services will be opened to competition by private operators with the PTTs. Regulation and network operation activities of the PTTs will be separated. EC officials plan to liberalize most telecommunication services by 1989 and the remainder, except basic services, by 1992. Unified standards for terminal equipment will be drafted and a directive on open network provisions proposed. The EC has already agreed upon and started to implement harmonized standards for certain new products, such as digital cellular radios. For equipment and data processing services, U.S. industry is generally supportive, though advocating a "no harm to the network" standard. The standards-drafting process is more accessible than in most sectors. On the other hand, a directive limiting the amount of non-EC-sourced broadcasting has the U.S. industry very concerned.
Miscellaneous ..	14	Includes an important "framework" directive affecting all construction materials. Also materials in contact with food, toys, personal protective equipment, and labelling are affected by directives in this category.
Generic	3	Included here are the issues of product liability, an expanded information procedure, and Good Laboratory Practices (GLPs).

[1] One June 9, 1989, the environment ministers of the European Community voted to introduce a shorter timetable for EC member states to comply with the newly adopted emission standards for automobiles with an engine size of 1.4 liters or less—which make up an estimated 60 percent of the total car population in Europe.
[2] Commission of the European Communities, *Fourth Progress Report of the Commission to the Council and the European Parliament Concerning Implementation of the Commission's White Paper on Completion of the Internal Market*, COM (89) 311, (Brussels, June 20, 1989), pars. 52 to 53.
[3] The new standard limits carbon monoxide to one-third of the current limit and reduces the limit for combined hydrocarbon and nitrogen oxide emissions by 70 percent. Its adoption is likely to require EC carmakers to develop or buy fuel-injection systems and three-way catalysts in order to control hydrocarbons, carbon monoxide, and nitrogen oxides. U.S. suppliers of such antipollution equipment could benefit.

Source: Compiled by the staff of the U.S. International Trade Commission.

standards directives.[71] For example, the current United States-EC hormone dispute is the result of an EC directive banning the use of hormones in red meat. Problems for U.S. suppliers can come at two stages:

(1) U.S. producers can have difficulty meeting essential requirements, in which case problems occur when directives come into force; or

(2) the technical specifications developed by regional bodies may be biased against non-EC suppliers, in which case problems occur when such EC-wide standards are adopted at the member-state level. It is generally too early to tell whether U.S. producers will have problems in this regard, since CEN and CENELEC have just begun work on standards related to 1992.

To date, U.S. exporters have had very limited access to the EC standardization bodies, and the EC Commission consults only with the EC industry and member states in laying out essential requirements.[72] The United States does not participate in the EC's regional standardsmaking bodies and does not have a formal means of commenting on draft standards developed by them.[73] The United States therefore has no assured means of securing changes if the proposed standards would be detrimental to U.S. suppliers.[74] The remarks of a representative of the medical devices industry were typical of firms in other sectors:[75]

> "We are counting on the U.S. government to make sure that the harmonized European community does not, wittingly or unwittingly, erect technical or regulatory barriers to U.S. medical technology products. . . As the system is presently set up, there is no mechanism for U.S. companies like mine to participate in the development of these standards."

However, U.S. technical institutes such as ANSI and the Commerce Department's National Technical Information Institute do not regularly receive copies of draft or final standards from these bodies, nor information on their expected standards-drafting activities or "work programs."[76] Indeed, EC officials have apparently decided "it is not in the interests of the Community or. . . probably of its trading partners to open European product standard setting for manufactured foods and products to U.S. and other non-EC industry representatives," according to a statement by an EC Commission standards expert on April 27, 1989.[77]

Since EC suppliers do participate in the drafting of technical specifications, they are in aposition to influence them and to adapt their product lines. EFTA countries also participate and will similarly benefit. Regional standards are also not notified to the GATT Standards Code unless they are translated into national regulations at the member-state level.

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[70]—*Continued*
Mr. Cooney noted that the major issues on NAM's watch list are harmonization of technical standards; new initiatives to require opening of EC members' government procurement to intra EC trade partners' and the general effort to restrict non EC trading partners' benefits to strictly reciprocal market opening relationships.

[71] For example, one U.S. industry representative asserted, "For manufacturers of EDP (electronic data processing) equipment, the directives will not be trade liberalizing. They will be trade restricting. . . .The new directives on ergonomics and electromagnetic emissions will impose a host of new requirements for these manufacturers. Unlike the United States, these requirements will not be restricted to electromagnetic emissions but will cover aspects such as immunity to line transients, electrostatic discharge and RF fields as well. Few U.S. products are designed to meet these standards." Formal submission to the U.S. International Trade Commission by Glen Dash of Dash, Strauss and Goodhue, Inc., Mar. 23, 1989.

[72] For example, in Apr. 13, 1989, testimony before the House Foreign Affairs Committee, Subcommittee on International Economic Policy and Trade, Stephen M. Lovett, Vice President of the National Forest Products Association, reports, "Gaining access to directives in the draft stage continues to be very difficult, and is vital to influencing their final form. NFPA plans to continue working with Commerce and USTR to insure that our industry is kept abreast of developments in the European Community." See p. 7 of written testimony.

[73] See, for example, letter to Charles Ludolf, Director, Office of European Community Affairs, U.S. Department of Commerce, from the National Machine Tool Builders Association, the Association for Manufacturing Technology. The letter stated that, "All parties understand that the United States will not be allowed to participate actively in the CEN Technical Committees, as is the case on committees operating under ISO and IEC procedures."

[74] In a letter to Charles Ludolf, Director, Office of European Community Affairs, U.S. Department of Commerce, from the National Machine Tool Builders Association, the Association for Manufacturing Technology stated that, "As noted in our recent conversations, all we expect from the EC harmonized standards operation is an opportunity to participate."

[75] Statement by Richard W. Young on behalf of the Health Industry Manufacturers Association before the Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade, Apr. 13, 1989, p. 2.

[76] In testimony before the House Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade of the on Apr. 13, 1989, a representative from the American National Standards Institute noted that in an attempt to increase its presence in Europe, it has requested —thus far unsuccessfully —observer status to CEN and CENELEC. The inability of the U.S. Government or of private bodies such as ANSI to have input into the drafting of European standards at the early stages was troubling to many of the individuals and groups testifying before Congress. See, for example, testimony of the National Association of Manufacturers before the Committee on Small Business, U.S. House of Representatives, Feb. 9, 1989, p. 11; the statement of the U.S. Chamber of Commerce before the House Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade on Apr. 13, 1989, p. 4; and testimony before the same subcommittee on Mar. 23, 1989, by a representative of MEMA, p. 4. These and other groups urged that the United States press for increased access to European standards-drafting groups in the appropriate international forums.

[77] As reported in the *International Trade Reporter*, May 3, 1989, vol.6, p. 565.

The development of uniform standards for all of Europe could improve U.S. business operating conditions in the EC by making it possible to supply one product to all EC markets and by facilitating the acceptance of goods moving from one EC member state to another.[78] In addition to scale economies, U.S. firms could benefit from additional flexibility in production and shipment and reduced administrative burdens. The so-called "low voltage directive" is an example of a "good" standard. The directive made it possible to market the same household electrical appliances throughout Europe (with different plugs).

Changes in testing and certification could benefit U.S. firms by providing assurance of access and streamlining administrative requirements. However, to the extent that conformity is defined as the use of particular processes and production methods, i.e., medical implements must be sterilized by a particular method, U.S. suppliers may be harmed.

Moreover, U.S. business is apparently concerned about the shape of the EC's draft policy on testing and certification. In February 9 testimony, the National Association of Manufacturers warned that, "proposed testing and laboratory certification rules. . . could virtually eliminate self-certification by manufacturers outside the EC and make third-party testing by non-EC laboratories virtually impossible. Few products are now covered by mutual recognition of laboratory testing standards, and existing draft proposals for a new EC system could lead to expensive modifications or costly and time consuming new testing practices for products that U.S. companies wish to ship to the EC."[79]

In a statement before the Subcommittee on International Economic Policy and Trade, a representative from the Motor and Equipment Manufacturers Association (MEMA) expressed concern over a proposal being drafted byCEN/CENELEC to establish an EC-wide product testing and certification system. The intent is to develop a system of lab accreditation and third-party testing as a complement to a manufacturers' own internal quality assurance and testing/self certification programs. MEMA feels this approach offers the potential for additional EC regulation of products produced within the EC as well as those exported to it. They also commented that non-EC manufacturers do not have adequate access to the EC standards-development process.

Diversion of Trade to the U.S. Market

In many cases, U.S. standards meet or exceed standards proposed by the EC directives. In those cases, products not meeting the EC standards are not likely to be diverted to the U.S. market. For some products, such as excavators, the U.S. market has already been penetrated and arguably saturated by imports. There are other areas, however, wherein some countries' products as presently manufactured may be largely shut out of the EC market and exports could be shifted to markets in the United States. Examples of these include power lawnmowers, forklift trucks, and agricultural and forestry tractors. Where structural design changes are required for products such as these in order to maintain a share of the EC market, exports may be shifted to markets that do not have standards that require expensive retooling.

U.S. Investment and Operating Conditions in the EC

Although some U.S. suppliers may benefit from harmonized standards and testing procedures, others may be put at a competitive disadvantage relative to European suppliers. Those U.S. interests presently with direct investments in Europe may be better placed to influence the decisionmaking process and to respond to 1992-related technical changes in their manufacturing operations. U.S. firms that supply the EC primarily through direct exports and that do not have a dominant industry position (thus "setting the standard"), have reported difficulty obtaining information and influencing the standards-drafting process.[80]

Although some U.S. firms with investments in the EC may decide to abandon that market rather than increase investment to meet new standards, probably more will increase investment to upgrade facilities in order to maintain or attempt to gain market share. Investment of this type is likely to be more "one-time" plant improvement than continuing investment.

Industry Analysis

On the basis of analyses of the directives included in the standards category, 13 directives or groups of directives were selected because of the types of issues they raise for the United States

[78] In testimony before the House Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade by Manuel Peralta, President of the American National Standards Institute on Apr. 13, 1989, he noted that EC producers and suppliers will not be the only ones to benefit from EC-wide standardization.

[79] Testimony of Stephen Cooney, Director, International Investment and Finance, National Association of Manufacturers on "The Implications of the European Community 1992 Plan for American Trade and Competitiveness," before the Committee on Small Business, U.S. House of Representatives, Feb. 9, 1989.

[80] In written testimony submitted by the American Plywood Association to the House Foreign Affairs Committee, Subcommittee on International Economic Policy and Trade on Apr. 7, 1989, "While the GATT Code requires that draft standards be made available for comment prior to promulgation this is too late in the process to effect important changes. The U.S. has been locked out of the European standards activity (CEN/CENELEC) even to the extent of being observers. The APA would like to participate as an observer and would do so if permitted."

and because they appear to be among those most important to U.S. interests. Analyses are presented below for each of the directives or directive groups.

Coordination of Laws and Regulations Relating to Broadcasting Activities (Directive 88/154)

Background

Directive 88/154 was constructed in order to facilitate broadcasting across the boundaries of EC countries; to limit the amount of non-EC-sourced programming broadcast; to limit the amount of advertising during broadcasts; to control the type of advertising broadcast to protect children from exposure to improper influences; and to encourage the production of EC-based programming.[81]

Anticipated Changes

Limits exist in many EC member states on the percentage of non-EC works that may be broadcast, ranging from about 12 percent in the United Kingdom to 40 percent in Italy. Limits established by directive 88/154 will be even more restrictive than those existing under current conditions. Under the directive, member states will ensure that television stations and cable operators retransmitting television broadcasts reserve at least 60 percent of their programming time, excluding news, sports, game shows, advertising, or teletext services, for EC works, of which at least one-third shall be reserved for first broadcasts in the EC.

If the proposed directive is approved, broadcast advertising would be limited to 15 percent of daily air time, and the frequency of advertising would be regulated by the type of program. Also, in the event that a cable operator and a copyrightholder cannot after a period of 2 years come to an agreement on remuneration for broadcasting a program, remuneration shall be determined by the competent authority, such as a court, an administrative authority, or an arbitration body.

Possible Effects

U.S. exports to the EC

This directive is considered to be trade discriminatory against non-EC countries, and will limit the amount of programming from sources outside the EC that can be broadcast within the EC. U.S. firms may be hit especially hard because they are one of the major sources of television programming and motion pictures in the world. Although there are few reliable statistics covering programming, it is estimated that in 1988 total U.S. broadcasting revenues abroad totaled about $3.5 billion to $4.0 billion, with the EC accounting for about $1.5 billion to $2.0 billion. The entire U.S. entertainment industry will be adversely affected by the reduced market in the EC for programs produced in the United States.

Directive 88/154 will not directly improve the efficiency or productivity of EC firms but will virtually guarantee them a larger share of the EC market for broadcasting and programming services. However, given the expansion of television stations and satellite television, it may be difficult for EC firms to satisfy the expected demand for broadcast programming.

Diversion of trade to the U.S. market

It is unlikely that there would be a diversion of trade to the U.S. market. Although there are no screen quotas in the United States, the U.S. market has never made substantial use of foreign-sourced programming. Although the U.S. Public Broadcasting System (PBS) uses about 12 to 14 percent foreign-sourced programming, mostly from the United Kingdom, and SIN, the Spanish language channel, uses an estimated 90 percent foreign-sourced programming, the broadcast networks use only about 1 to 2 percent foreign-sourced programming. U.S. audiences are more likely to watch programs in English than those with subtitles or dubbing.

U.S. investment and operating conditions in the EC

U.S. companies such as United Cable, ESPN, Disney, and some Bell regional companies have been investing in cable TV and satellite networks in Europe and depend on advertising revenues to recoup their investment. If these new technologies and services are not viable because advertising revenues are restricted due to the adoption of Directive 88/154, these U.S. investors are expected to be adversely affected. Cable networks such as CNN have made considerable investments to export their network services and participate in the new European market. CNN is entirely an advertiser-supported service and, as such, is highly vulnerable to EC restrictions. Although it may be easier for members of the EC to broadcast across national borders because of the directive, the interests of U.S. companies are adversely affected at virtually every level. Limits on non-EC programming will mean limits on advertising revenues generated by non-EC programming.

[81] The EC's policy on broadcasting is apparently also related to its intention to develop a European standard for high-definition television. In April 1989, the Council adopted a decision establishing the main lines of overall EC policy in this area, which the EC Commission is now implementing.

With the establishment and expansion of satellite television services in the EC, demand by viewers for video programming will increase dramatically. The establishment of this directive will prohibit the U.S. programmers from competing fully for this huge market. However, the inclusion of the phrase "where practical" has been proposed, in reference to the limit on foreign-sourced programming. Such a vague term could still provide an opportunity for U.S. producers if EC programmers are unable to provide these services.

Programming and motion pictures produced in the EC by U.S. investment will not be affected by this directive as long as the U.S. investment is subordinate to a producer established in the EC. The directive requires that non-EC programming be limited to no more than 40 percent of broadcasts other than news, sports, game shows, or teletext. EC programming is defined as that in which an EC producer has a majority of control. Therefore, under the directive, 60 percent of programming in the EC (with the exclusions noted above) is set aside for EC producers.

U.S. Industry Response

The International Trade Administration of the U.S. Department of Commerce is working with the U.S. industry and with the EC to seek modification or elimination of the proposals on screen quotas and advertising. It would not benefit the United States to impose a reciprocal standard directed at the EC, because the United States makes little use of foreign-sourced programming.

The U.S. audiovisual industry is concerned about the EC directive on several counts. First, according to industry contacts, the directive establishes a minimum quota for EC program material of 60 percent, which, conversely, establishes a limit of 40 percent on non-EC programming. Second, the draft directive ignores crucial copyright issues, despite the fundamental questions raised by new media such as direct satellite transmissions and cable retransmissions.

Views of Interested Parties

No formal submissions were received.

Growth-Promoting Substances in Meat (Directives 85/358; 86/469; and 88/289)

Background

The EC seeks to safeguard its citizens from consumption of unsafe meat products through the restriction of imports of "contaminated" animals and meats therefrom. Of particular concern are animals and meat products treated with growth-promoting hormonal or thyrostatic substances. Misuse of such substances has occasionally led to excessive residues in the meat of animals and, apparently, to harm to consumers. These directives are ostensibly designed to prevent such misuse. However, some U.S. industry interests contend that they are in fact designed to support the EC industry by reducing current meat surpluses in the EC market.

Anticipated Changes

These directives place restrictions on EC imports of certain substances having a hormonal or thyrostatic (i.e., growth-promoting) action and on live animals and meat products from animals that have been treated with such substances. Affected products include beef, veal, pork, mutton, and lamb. Directive 85/358 prohibits EC imports of such growth-promoting substances. Directive 86/469 contains detailed arrangements for testing procedures and commercial controls on animals and meat products that are treated with such substances, antibiotics, or pesticides. Directive 88/289 concerns health and veterinary inspections for EC imports of bovine and porcine animals and fresh meat, and, in particular, defines "fresh meat" as coming from animals to which no restricted substances have been administered and as containing no residues of restricted substances.

Possible Effects

U.S. exports to the EC

The restrictions imposed by these directives have the effect of banning almost all EC imports of meat and meat offals from the United States. The value of U.S. exports to the EC of the affected products is estimated by USITC staff at $150 million to $200 million per year, or about 15 to 20 percent of total U.S. beef exports of about $1 billion, and about 1 percent of U.S. production of $20 billion to $25 billion per year. The U.S. share of the EC market is estimated by USITC staff at less than 5 percent in recent years. U.S. imports from the EC of meat and edible offals (almost all of which consist of pork and canned hams) are about $500 million annually.

Not all U.S. meat exports are affected by these directives. Texas cattle ranchers and the Texas Agriculture Commissioner have reportedly negotiated with EC veterinarians a verification procedure to ensure EC acceptability of certain Texas-produced beef. The Texas action was controversial (in that it reportedly interfered with the U.S. policy (see below) formulated by then-United States Trade Representative and current USDA Secretary Clayton Yeutter of certain trade retaliations taken against the EC in response to its meat ban), but it was intended to help U.S. exporters maintain a position in the EC meat-import market.

Diversion of trade to the U.S. market

Besides the United States, the only significant exporters of meat to the EC market are Canada, Australia, Argentina, Brazil, and New Zealand. None of the latter producers currently export meat treated with the restricted substances, and their exports therefore have not been adversely affected by the EC directives. Consequently, there are no trade-diversionary effects on the U.S. market. In addition, there are limits on the level of U.S. meat imports (mainly beef), so even foreign increases in meat production might not result in increased shipments to the United States.

U.S. investment and operating conditions in the EC

U.S. investment in the EC livestock and fresh meat industry is negligible and will not be significantly affected by the EC directives.

U.S. Industry Response

On July 14, 1987, the Meat Industry Trade Policy Council (consisting of the American Farm Bureau Federation, the American Meat Institute, the National Cattlemen's Association, the National Pork Producers Council, and the U.S. Meat Export Federation) filed a complaint with the United States Trade Representative under section 301 of the Trade Act. The complaint alleged that the EC is imposing an "unjustifiable and unreasonable restriction" on U.S. exports of meat products. When the EC ban went into effect at the start of 1989, the United States retaliated by imposing 100-percent tariffs on U.S. imports from the EC of certain food products; the estimated value of U.S. imports from the EC of the retaliated products is approximately $100 million, an amount comparable to the estimated revenue lost by U.S. meat exporters because of the EC ban.

At a meeting on February 18 to 19, 1989, U.S. and EC officials agreed to establish a joint task force to work out the technical problems associated with the exportation of hormone-free beef to the EC. The task force was given 75 days to make its findings. On May 3, 1989, the task force officials signed an interim agreement. Under the agreement, EC officials will examine feedlots of those U.S. producers interested in exporting to the EC and will certify that the animals have not been treated with growth-promoting substances. The U.S. Department of Agriculture's Food and Safety and Inspection Service (FSIS) would be responsible for separating this beef from uncertified beef at the slaughterhouse but would take on no other new responsibilities. Reportedly, the single EC inspector already working in the United States will take on the full responsibility of certifying that livestock is free of growth-promoting substances.

Talks will resume despite the agreement, since the two sides have not resolved the issue of how to address U.S. exports of "variety meats," such as tongue and liver, to the EC. About 70 percent of U.S. beef exports to the EC are variety meats used for human consumption. The U.S. Government is not expected to modify its retaliation until trade actually resumes.

The Meat Industry Trade Policy Council views the EC directives as an "unjustifiable and unreasonable restriction" on U.S. exports of meat products. In contrast, according to press reports, the Texas Agriculture Commissioner views the U.S. Government response to the EC directives as "totally unnecessary. . . We [Texas] saw it not as a matter of health or ideology, but as a marketing opportunity. Here was our largest customer saying they wanted a specialty cut of beef, and based on the old entrepreneurial concept that the customer is always right, let's sell that to 'em, since we have it."

Views of Interested Parties

No formal submissions were received.

Permissible Sound Emissions of Lawnmowers (Directives 88/180 and 88/181)

Background

These directives amend directive 84/538, relating to allowable noise levels of lawnmowers, by expanding its product coverage and will finalize the last of the provisions dealing with noise levels of mowers. The 1984 directive established maximum levels for airborne noise emissions (the "sound power or sound pressure" level) and a common method for measuring them.

Directive 88/180 adds motorized cylinder (reel) mowers to the coverage of directive 84/538. These mowers were originally excluded from the 1984 directive because they are equipped with a reel (as opposed to a rotary) cutting device similar to that used in the "old" push-type mower. Assuming directive 88/180 is implemented as scheduled July 1, 1991, the noise standards of the 1984 directive would apply to almost all lawnmowers, including riding mowers, for home and professional use.

Directive 88/181 limits the level of noise for riding mowers with a cutting swath of more than 120 cm and specifies the method for measuring the emissions. The provision was adopted to comply with a requirement that procedures for measurement be included in the directives pertaining to the equipment. The sound pressure provisions were originally included in directive 79/113, as last amended by directive 85/405, dealing with noise emissions of construction plant and equipment.

Anticipated Changes

Directive 88/181, scheduled to take effect July 1, 1991, will most likely require the noise level of the riding mowers to be reduced further. The directive limits sound pressure to not more than 90 dB (decibels). This standard compares with a U.S. industry practice of limiting the level to not more than 95 dB. The difference between them is significant, because the intensity of the sound doubles every 3 dB. The proposed EC standard reportedly is also lower than the allowable noise levels being proposed by the International Standards Organization (ISO), which has drafted standards for airborne noise emissions by mowers for home and professional use (ISO 5395/2).

Directive 88/181 may also possibly change industry procedures for measuring sound pressure. The sound pressure level must be measured at least three times, until two readings are obtained that do not differ by more than 1dB. The U.S. industry and the proposed ISO standards allow readings to be used when the power levels fall within a range of 5dB. The 1dB limit will increase the test time and cost to manufacturers.

Possible Effects

U.S. exports to the EC

The potential exists for directive 88/181 to adversely affect U.S. exports. Most of the ongoing recovery in U.S. exports to the EC is occurring in riding mowers, which accounted for three-fourths of the total value of exports there in 1988. Riding mowers are usually equipped with larger, and resultantly noisier, engines than those used in walk-behind mowers, the principal type made and sold in the EC.

World production and consumption of lawnmowers is concentrated in the United States; the EC, especially the United Kingdom and France; Canada; and Japan. The United States ranks as the world's largest producer and dominates the EC market for riding mowers. A number of U.S. firms have developed important markets and channels of distribution in the EC. The U.S. industry could be adversely affected by the noise requirements of directive 88/181 as it was by the 1984 directive, which affected producers of both lawnmowers and the engines used in their manufacture. Industry sources indicated that riding mowers can meet the EC noise standards at engine speeds of less than 2800 rpm, although engine speeds have been reduced by manufacturers to 2400 rpm to ensure compliance. However, because these mowers were originally designed to operate at engine speeds of between 3300 and 3600 rpm, the cutting and engine performance is adversely affected.

The EC remains the largest export market for the United States in lawnmowers, despite considerably fewer mowers being shipped there now than in 1980. In terms of value, these exports continued to recover from the depressed levels of the early 1980s, increasing at an average annual rate of 55 percent during 1984–88, to $123 million in 1988. Consequently, the EC's share of the total value of U.S. lawnmower exports, at $204 million, expanded from just under 40 percent in 1984–85 to 60 percent in 1988. The EC also accounted for about 6 percent of the total value of U.S. industry shipments that year. The only other significant export market for the U.S. industry is Canada, whose 15-percent share ($31 million) of U.S. exports made it the second-largest single-country market in 1988 after France, with 31 percent. The United States and Japan each supplied 24 percent of EC imports of lawnmowers in 1988.

Diversion of trade to the U.S. market

Directive 88/181 could also adversely affect Japan and, in turn, could result in a diversion of trade to the United States. Japan is a major exporter of lawnmowers to international markets, with the EC being its second-largest market after the United States. Japan's major export markets, on the basis of trade during January–September 1987, consisted of the United States (53 percent), France (14 percent), the United Kingdom (6 percent), and Canada (6 percent). U.S. imports of Japanese lawnmowers increased steadily during 1984–87 before declining by 23 percent in 1988, to $45 million. Japan remained the largest supplier by far, although its share of the total value of imports decreased from nearly 70 percent in 1984 to 54 percent in 1988. The extent of any diversion of Japan's EC-bound trade to the U.S. market would most likely be modest, partly because Japan's major producer now manufactures lawnmowers in the United States. The potential impact of any diversion of trade from the EC on the U.S. industry is likely to be offset somewhat by the industry's favorable demographics. According to the U.S. Department of Commerce, U.S. demand for lawn and garden equipment, which closely tracks changes in personal income and housing construction, will probably rise by 1.6 percent annually (constant dollars) during 1989–93.

U.S. investment and operating conditions in the EC

Assuming that directive 88/181 is adopted, U.S. investment in riding-mower production in the EC would most likely be adversely affected. To meet the noise standards of the 1984 directive, implemented in July 1987, U.S. firms had to reduce the noise levels of their mowers significantly. The firms reportedly either lowered the engine speed of their mowers, with a resultant decrease in cutting quality and engine

performance, or used a redesigned engine, cutting blade, and/or noise guard, with a resultant increase in costs stemming from new product development and testing.

U.S. Industry Response

The U.S. industry, through its trade association of original-equipment manufacturers and producers of engines for use in lawnmowers, has been working with the ISO on the development of international safety standards for mowing equipment. The U.S. industry formed a technical advisory committee to examine existing safety standards, including those dealing with noise emissions, and is participating in the revision of existing ISO standard 5395, which specifies safety requirements and test procedures for powered lawn-care equipment.

The major producers contacted in this industry contacted feel that the present ISO standards governing permissible sound-power levels of lawnmowers should be adopted by the EC Commission. Industry officials are concerned that if new standards are adopted for EC member states, structural changes to the design of power lawnmowers will be required that will substantially alter the equipment's performance. U.S. producers currently enjoy a large market share in the European power-mower industry. There is concern industrywide that changes in the internationally recognized standards will jeopardize the reputation of U.S.-built machinery.

Views of Interested Parties

No formal submissions were received.

Safety Requirements for Self-Propelled Industrial Trucks (Directive 86/663)

Background

In the early 1970s, European forklift manufacturers became increasingly concerned about national design-oriented standards and believed that these standards hindered export business between member countries. For example, when French forklift manufacturers sought to make automotive layout pedals and detachable gas tanks mandatory on all forklifts, other European producers complained to the EC in Brussels. As a result, the EC Commission drafted this forklift truck directive, which was examined by the British Parliamentary Select Committee in 1979. However, the British Government would not approve the directive until 1986, when all the technical appendixes and addendums had been discussed and clarified.

Anticipated Changes

Directive 86/663, which was scheduled to take effect January 1, 1989, requires U.S. manufacturers that have EC subsidiaries or that export to the EC to subject their lift trucks to EC certification and to modify their manufacturing process. The directive states that the manufacturer or authorized representative in the EC shall certify that each industrial truck conforms with the requirements of this directive.

Additionally, the directive sets for electrical forklift trucks 35 requirements pertaining to batteries, floating circuits, the cab switch, the draw-bar pull, and independent braking systems. The directive also lists certain requirements for internal combustion engine trucks including restrictions on containers, liquid-petroleum-gas piping, and regulations regarding the design and performance of other equipment. The directive sets requirements for forklift trucks with respect to visibility and access to the vehicle.

Possible Effects

U.S. exports to the EC

At the current time, industry sources report that this directive can be interpreted as both trade liberalizing and trade discriminatory. Although the harmonization of these standards is trade liberalizing for U.S. forklift producers as well as other producers outside of the EC, the directives may also be interpreted as trade discriminatory toward non-EC suppliers in that it will place extra requirements on non-EC suppliers that are fairly costly. For example, articles 4 and 5 require that the manufacturer be established within the EC or have an authorized representative in the EC who will certify that the individual forklift conforms to the directive. In order for a non-EC supplier to remain in the EC market, it must establish an facility within the EC Community or establish a relationship with an authorized representative who will perform all the required tests. Many manufacturers are unwilling to turn their products over to an authorized representative for certification as they fear they may become involved in a legal battle concerning product liability. Therefore, non-EC suppliers are at a disadvantage in comparison with EC suppliers with respect to certification costs.

Several larger U.S. manufacturers are concerned about the vagueness of some of the standards and believe that certain countries may try to clarify the requirement in a way that would be particularly damaging to U.S. producers. For example, regarding the requirement concerning access to the vehicle, the directive states that a step can be a maximum of 500 mm off the ground. U.S. manufacturers can comply with this requirement, but are concerned that since the requirement does not specify only one step that another country, such as France, would be able

to specify that two steps, one on each side, be required. This requirement would prove very costly for U.S. companies, as they would need to redesign the frame and change their tooling.

Of the approximately $463 million of U.S. forklifts produced in 1988, about 8 percent, or $37 million, were directly exported to the EC market. These exports represented approximately 19 percent of the $189 million in total U.S. exports of self-propelled industrial trucks in 1988. At $71 million, Canada remained the largest market for U.S. exports of this product in 1988, accounting for 38 percent of U.S. exports of industrial trucks. The relatively low level of direct U.S. exports to the EC may be partially attributed to the fact that most of the larger U.S. manufacturers of self-propelled industrial trucks are multinational firms that serve the EC market from facilities within the EC.

Diversion of trade to the U.S. market

Acording to industry sources, the two largest suppliers to the EC were the United States and Japan. However, Japanese exports of forklifts to the EC have been limited under a voluntary restraint agreement negotiated in 1985. The limit for 1987 was 14,000 trucks. During the last several years, Japanese producers have increased their exports of industrial trucks to the United States. Exports to the United States as a share of total Japanese exports reached a high of 48 percent in 1986. In view of what happened following the EC's quantitative restrictions on Japanese industrial trucks, industry sources claim that if the Japanese forklift industry is injured as a result of these directives, their exports will be diverted to the U.S. market. However, this diversion would not be expected to be as large as it was in the mid-1980s because most Japanese self-propelled industrial truck producers are now manufacturing in the United States.

U.S. investment and operating conditions in the EC

This directive is most likely to positively impact existing U.S. investment in the EC because the broader and potentially less protected EC markets should provide U.S. transplants with increased opportunity for sales from their existing locations. In addition, this directive should encourage future U.S. investment in the EC because U.S. suppliers will now find it more costly to export to the EC in view of the new testing and certification requirements imposed as a result of this directive. At present, U.S. producers of industrial trucks indicate that their U.S. investment in the EC accounts for approximately 35 percent of total investment in this product area in the EC.

Most U.S. producers indicated that this directive has affected their business operating conditions, and they expect that it will further affect them. These producers stated that they have had to implement a number of design changes and have had to establish the operating procedures necessary to meet the testing and certification requirements included in this directive. Many of these producers are very concerned about the forthcoming test procedures on noise, as they believe compliance with these standards might prove to be very costly. Presently, these standards on admissible noise levels are being held in abeyance owing to the objections by EC industrial truck producers. Originally, this standard would have mandated that industrial truck producers erect a separate facility for the testing of noise levels and invest in a large number of new instruments for this purpose.

U.S. Industry Response

Most U.S. manufacturers contacted support the concept of 1992 integration. They welcome the opportunity to sell their products in a "single" market that has only 1 set of rules rather than 12. However, they believe some of the standards are very vague and will prove to be costly for U.S. manufacturers, especially those regarding certification. Some U.S. manufactures are irritated that they were not given the opportunity to express their views while these standards were being drafted. They also take exception to the lack of timeliness in making the test procedures available.

U.S. exporters of industrial trucks are very likely to either discontinue exporting or establish a joint venture with a company within the EC in order to lower the costs associated with testing and certification. U.S. manufacturers that already have subsidiaries in the EC have implemented the design and testing requirements and are continuing to market their products in the EC. However, U.S. manufacturers stated that they are very dismayed that they did not have a means of participation during the drafting of this standard. Those U.S. manufacturers that have facilities in the EC were only able to voice their concerns as a European producer through their respective trade association in the EC. According to company sources, the U.S. Industrial Truck Association's engineering committee has only briefly discussed this directive and did not take or plan to take any action. In addition, the American National Standards Institute has not taken a position with regard to these standards.

Views of Interested Parties

No formal submissions were received.

Standards for Agricultural or Forestry Tractors (Directives 87/402, (87) 194, 88/465, 88/297, and (88) 629)

Background

These five directives govern changes to present internationally recognized standards for agricultural and forestry tractors. With the exception of directive 88/297, which revises laws relating to type-approval markings on the tractors, these directives all pertain to certain structural and protective features on the equipment. In this regard, directives 87/402, (87) 194, 88/465, and (88) 629 are similar in that they will amend present specifications for tractor safety. These directives have been introduced in order to harmonize the differing national and international laws that have thus far made intra-EC trade a complicated matter. As a result, an EC-wide type-approval system will enter into force on January 1, 1990.

Anticipated Changes

Directive 87/402, originally scheduled to take effect June 26, 1989, revises the laws defining which tractors must be fitted with rollover protection structures in front of the driver's seat on narrow-track wheeled agricultural and forestry tractors. This directive makes previously unaffected equipment subject to the specific requirements of EC type-approval procedure. In addition to a wider variety of product that is subject to the safety standard, new component type-approval marks will be required to show the tractor was manufactured in conformity with the standards. An admendment to the directive, (88) 629, was proposed by the EC Commission on November 18, 1988. It extends the deadline for member-state implementation until October 1, 1989, and provides for a procedure for prior consultation between the EC Commission and the member states concerning adaptation of the annexes to directive 87/402 to reflect technical progress. It also changes one of the technical annexes to directive 87/402 and calls upon the EC Commission to draft further changes in the annexes to reflect the technical progress.

Directive (87) 194, implemented on December 1, 1988, relates to the harmonization of many technical requirements that individual member states have for tractors.[82] The proposed EC legislation reportedly requires further structural changes in addition to or in place of existing national regulations. In particular, with regard to the technical requirements relating to safety glass, a previously adopted United Nations agreement from March 1958 will be amended and implemented as the uniform condition.

Directive 88/465 changes internationally recognized industry standards of weighted acceleration of the vibratory movement of tractor seats. The changes are very technical amendments to the length of time it may take a tractor seat to return to a resting position after movement induced by the weight of the operator. The weighted acceleration of the vibratory movement is measured at various intervals of time depending upon the class and category of the tractor. All member states may refuse to grant national type-approval and entry to any tractor that does not comply with the provisions of the above-mentioned directives.

Directive 88/297 revises laws relating to the marking, by abbreviation, of some tractor parts that no longer need to meet EC standards for type-approval. This change was necessary because it may have become superfluous to adopt EC rules for some tractor parts that are used less frequently in tractor manufacturing and that have been replaced by other devices. The directive requires that the abbreviation used to exempt some tractor parts from the type-approval process be changed from 'SD' to 'CONF.' The abbreviation 'CONF' is considered to be a minor change and is not expected to have any great effect on the competitiveness of U.S. tractors.

Possible Effects

U.S. exports to the EC

With the exception of directive 88/297 governing markings for type-approval of tractor parts, the potential exists for these directives to be trade discriminatory against the United States. The main U.S. producers of agricultural machinery of the type affected by these directives manufacture their product both domestically and in Europe. Whereas their biggest single market in value terms is the United States, due to the larger, more expensive equipment used by U.S. agriculture, the volume of tractors sold is greater in Europe. U.S. suppliers anticipate that complying with the new and perhaps more stringent EC standards will be damaging to their market share if the standard is vastly different from the ISO standard currently in use. The standard will also be considered especially damaging if it requires structural design changes

[82] Covered are laws regarding tractor dimensions and masses, speed governors, the protection of drive components, projections and wheels, the trailer brake control, windscreen and other glazing, the mechanical linkages between tractor and trailer, and the location and method of affixing statutory plates and markings to the body of the tractor.

to be made to the equipment and production process. Moreover, the quantity of changes that must be made to tractors that sell across Europe could take manufacturers considerable time and, over the long run, could be damaging to well-established U.S. market positions.

At present, however, the problem U.S. industry foresees in exporting is in trying to determine exactly which tractors are affected by the EC standards. Many of the structural standards are unclear as written in the proposed legislation. Assuming that many different lines of tractors are affected and that more time and capital are needed to modify existing machinery, each U.S. manufacturer must decide if continued sales to Europe are worthwhile in the long run.

World production and consumption of tractors are concentrated in the EC (especially in West Germany and the United Kingdom), Canada, the United States, and Japan. As a whole, production in the EC accounted for 30 percent of world output in 1987 and supplied over 80 percent of EC consumption. The EC has not been an especially large export market for U.S. or world producers, partly because foreign firms have transferred a large part of their production capacity to Europe. U.S. multinationals now account for 40 percent of total EC output.

The United States ranks as a leading manufacturer of large, over-100 horsepower (hp) tractors, which it produces for a growing domestic market and for export. The U.S. share of the EC market remains negligible. The United States supplied 1.5 percent of EC imports of agricultural or forestry tractors in 1988. Instead, the bulk of EC demand is satisfied by local production of U.S. subsidiaries. U.S. exports to the EC, at $350 million, accounted for about 6 percent of the total value of U.S. industry shipments in 1988.

U.S. exports to the EC are expected to improve somewhat in the next several years as consumption trends among European farmers change. In Europe, the trend toward larger, more powerful machinery is growing. Although the volume of sales may be dropping, there has been an increase in the power and size of the new machinery. U.S. producers are inclined to believe this will result in greater sales abroad of over-100 hp tractors.

The most significant export market for the U.S. industry has been Canada, which accounted for $520 million, or 30 percent of total U.S. exports of $1.7 billion in 1988. The EC ranked second, accounting for 20 percent of total U.S. exports. Exports to Japan, on the other hand, steadily increased during 1984–88 and accounted for approximately 8 percent, or $136 million of total U.S. exports in 1988.

Diversion of trade to the U.S. market

Directives 87/402, (87) 194, and 88/465 could also be trade discriminatory against the other exporting countries of wheeled agricultural or forestry tractors. The directives may be damaging to third-country exporters because there will be many structural design changes that will be required in order to market the machinery in the EC. These changes will not be required in other markets where the exporters may have a larger portion of the domestic market.

Japan, which currently provides the EC with 2 percent of all imports, has expanded its share of the market for 40 to 100 hp tractors. Based on the growing segment of Japanese production in this area and in response to demand in Western Europe, it appears that Japan plans to gradually increase its world share of the small- and medium-sized tractor market. If this market were to be closed to them, Japanese producers have the option of routing their exports to the U.S. market. Industry analysts predict that U.S. farmers will begin updating their farm equipment, and retail sales of most equipment is expected to double in the first few months of 1989. Imports accounted for nearly 85 percent of tractor sales in the United States for 1988. During 1984–88, total U.S. imports of tractors rose by 24 percent. Aside from Japan, which supplied 29 percent of these imports in 1988, the other significant suppliers were the United Kingdom with 22 percent, West Germany with 16 percent, and Canada providing 15 percent.

U.S. investment and operating conditions in the EC

The U.S. agricultural machinery industry has undergone significant restructuring since the early 1980s. Falling demand from farmers, the major customers, has caused the industry to rationalize production worldwide and has resulted in a very internationalized and specialized industry. A number of major U.S. producers have relocated production in Europe, with some removing all their production capacity from the United States. This new strategy has helped U.S. firms to lower production costs and at the same time increase their share of the market. Assuming these directives are adopted, conditions would be such that two very different effects could result. On the one hand, existing and potential U.S. investment in wheeled agricultural and forestry tractors would most likely be adversely affected. Structural and design changes, in addition to production alterations needed to comply with the proposed standards could cause undue increases in the cost of production to original equipment manufacturers. Such cost increases translate to higher per-unit cost to the consumers and eventually result in diminished market shares. Today, 90 percent of U.S. and European

production is concentrated in Europe; 40 percent of this is from U.S. multinationals.

On the other hand, U.S. producers already located in Europe may stand to gain from the harmonized regulations. U.S. producers could be in a position to further expand their product line and market share from a less confusing environment without many different national standards. However, U.S. producers may further concentrate their manufacturing efforts in the EC and decrease the amount of supplies they obtain from the United States. Such a move would in effect further reduce domestic sourcing in favor of offshore production.

U.S. Industry Response

The U.S. industry and its trade association are concerned that harmonization of standards conducted under the guise of the elimination of internal barriers will actually build external trade barriers. Whereas the industry would welcome harmonized use of preexisting ISO standards governing farm machinery, it is expected that the EC may favor member state national standards.

U.S. original-equipment manufacturers are frustrated by the difficulty of providing input to the EC on the development of new standards. They feel that there is a lack of reciprocity in this area and have considered leaving the European market as an alternative to major design changes that could add to the price and lower cost efficiency in production of tractors.

The industry's major producers that were contacted are opposed to any change in present international standards and feel that these directives are unnecessary and not clearly stated. These producers feel that by increasing production costs, the new standards will cause unit price to increase and eventually reduce the competitive status of U.S.-produced machinery.

Views of Interested Parties

No formal submissions were received.

Construction Products (Directive (87) 728)

Background

This proposal amends proposal (86) 756 with the intent to insure that construction products sold in the EC market would be "fit for their intended use," and would meet general safety criteria.

Anticipated Changes

The EC will create internal bodies to certify all manner of construction products for safety, hygiene, and manufacture for intended use. An EC Standing Committee for Construction will oversee member states' certifying procedures. Directive (87) 728 was passed by the EC in December 1988 for implementation January 1, 1989. CENELEC is still developing European building codes which will have an impact upon the implementation of the newly passed directive.

Possible Effects

U.S. exports to the EC

Because the products and classifications covered by the directive have yet to be defined, a quantitative estimate of the trade impact of the directive cannot yet be made. However, a qualitative assessment is possible. The products most likely to be affected by the directive encompass the range of construction products used in building and civil engineering: all materials, frames and assemblies, installations, and building works. In one category alone—wood products—the U.S. exported $875 million worth of products to the EC in 1988, representing a 30-percent increase over 1987 exports.[83]

Consequently, the potential impact of this directive on U.S. exports is quite large. U.S. exports of construction products may decline significantly if the newly developed construction standards and building codes contain specifications different from those used in the U.S. industry; for example, if the EC insists on excluding nonmetric dimension of wood products, U.S. exports to the EC of plywood, lumber, frames, and other wood products would decline substantially. Similar effects may be expected in other sectors of the U.S.-construction-products trade. Moreover, the reportedly close coordination between the EC and major exporters in the EFTA countries in the development of such standards and codes indicates that they may indeed adversely affect U.S. exports.

Diversion of trade to the U.S. market

The U.S. market for construction products is mature and imports already have a well-established presence. Exports diverted from third-country suppliers to the EC are not likely to enter the U.S. market at a higher level than current U.S. imports.

U.S. investment and operating conditions in the EC

There is little or no U.S. investment in the EC construction products industry. However, the costs of marketing U.S. products in the EC will increase if the directive is fully implemented and enforced, because the costs of meeting the certification and inspection requirements applied

[83] Testimony by the National Forest Products Association before the House Committee on Foreign Affairs, Subcommittee on International Economic Policy and Trade, Apr. 13, 1989.

to products imported into the EC could be higher than those applied to goods produced within the EC.

U.S. Industry Response

Representatives of the U.S. construction-products industry indicate that the directive, as written, is without good definition and is too general to base a constructive industry response on. In addition, they report that the mention of a European certifying body is worrisome; such a body (yet to be developed) might be given the authority to decide the commercial viability of a certain construction product in the EC market, above and beyond any justifiable controls for safety, hygiene, or manufacture for intended use. Moreover, there does not appear to be a check-and-balance system present in the directive, nor an appeals process.

The wood-products industry in particular has indicated concern about the possible barrier to entry of U.S. products into the EC market. According to industry representatives interviewed by USITC staff, U.S. producers would be competitive in the EC market if allowed to compete solely on the basis of price and quality. They report that the EC is considering quality certification marks for European wood products, which could further hinder U.S. exporters. Housing construction companies, for example, might not buy U.S. lumber if mortgage companies refused to finance a house built with lumber that was not EC certified.[84]

The U.S. industry response apparently has been hampered by the vagueness of the directive, particularly because there is not yet any identification of the affected construction products or a definition of the relevant technical specifications and building codes.

Views of Interested Parties

No formal submissions were received.

Machinery Safety (Directive 87/564)

Background

The directive was proposed with two stated objectives: (1) to introduce EC legislation on the prevention of industrial accidents, and (2) to eliminate barriers to trade arising out of the disparity of such provisions. There is some evidence that national standards on machinery safety in the member states are a significant barrier to trade in the EC market.[85] Additionally, accidents caused by the use of machinery were high in the EC. At the same time, it was recognized that small and medium-sized firms were effectively prevented from exporting because of the incompatibility of machinery safety standards between member countries.

Anticipated Changes

Member countries are to change their national laws to incorporate the safety core requirements contained in this directive, which was adopted on June 14, 1989, but has not yet been implemented by the member states.

Machinery is defined in this directive as "an assembly of mechanically linked parts or components, at least one of which moves, with the appropriate actuators, control and power circuits, etc., joined together for a specific application." It also "covers complex installations, namely an assembly of machines and equipment which, in order to achieve the same end, are arranged and controlled so that they function as an integral whole" and "in particular for the processing, treatment, moving or packaging of a material."[86]

All machinery, as defined in the directive, is to be subject to certain "Principles of Safety Integration," marked to indicate conformity with the EC directive, and provisioned with an "instruction handbook." In certifying, the manufacturer must construct a technical file showing how the machine conforms. Once there is conformity, the mark of "C" is to be displayed on the machine. Documentation on the conformity to safety requirements must be kept for 10 years. If the machine is not produced in the EC, the obligation to keep documentation falls on the person placing the machinery on the

[84] USITC staff meetings in London with Southern Pine Marketing Council & Western Wood Products Association (United States) and American Plywood Association, United Kingdom, May 2, 1989.

[85] On Mar. 28, 1983, the Council of the European Communities adopted a directive coordinating the development of standards in the EC, the so-called Mutual Information Directive discussed above. In 1984, approximately 80 national draft technical regulations on machinery safety were modified to accord with the 1983 legislation. Approximately 25 percent of the draft standards were subject to detailed EC Commission opinions owing to the incompatibility of these drafts with EC law.

[86] Excluded from the scope of this directive are: mobile equipment; lifting equipment; machinery whose only power source is directly applied manual effort; machinery for medical use used in direct contact with patients; special equipment for use in fairgrounds and/or amusement parks; steam boilers, tanks and pressure vessels; machinery specially designed or put into service for nuclear purposes which, in the event of failure, may result in an emission of radioactivity; radioactive sources forming part of a machine; firearms; storage tanks and pipelines for petrol, diesel fuel, inflammable liquids and dangerous substances. If the machinery are wholly or partially covered by a specific Community directive, this directive shall not apply. For machinery where the risks are mainly of electrical origin, such machinery shall be covered exclusively by Council directive 73/23 of Feb. 19, 1973, which relates to low voltage electrical equipment.

EC market. Safety standards for machinery having higher safety-risk factors, such as woodworking machines, certain types of metalworking machines, and plastics- and rubber-molding machinery, which are listed in annex IV of the directive, are subject to stricter certification procedures. Accreditation of bodies allowed to certify and test to conformity is not addressed in this directive.

The program is to be implemented and organized by the various CEN technical committees so as to ensure that by the directive's planned date of entry into force, manufacturers and the competent authorities in the member states have an adequate collection of European standards to ensure that essential requirements are uniformly interpreted throughout the EC. If that condition is not met, there is a risk of excessive use being made of voluntary systems for the certification of machinery by specialized bodies, which in the absence of standards will arrive at their own interpretation.[87] There are already certification systems of this kind in some member states and they will probably eventually form a unified European certification network. In the case of machine safety, manufacturers' declarations of conformity will generally be permitted if producers have in place recognized quality assurance programs.[88] Exceptions, such as chain saws, are specified in the directive.

Possible Effects

U.S. exports to the EC

U.S. exports to the EC of the products affected by this directive are estimated to have totaled $3.8 billion in 1987. The estimated EC market for the products is between $127 billion and $139 billion.

U.S. firms that sell in the EC market would benefit from lower costs derived from economies of scale resulting from manufacturing products designed to meet, at a minimum, one set of standards. These industries are believed to be those with more than $100 million in U.S. exports to the EC. These include the industries producing engines, including gas turbines, not used to propel means of transport; miscellaneous machinery; semiconductor manufacturing machinery; printing machinery; centrifuges and filtering machinery; pumps for liquids, excluding those used in means of transport; refrigerators and refrigerating machinery; taps, cocks, and valves; certain metalworking machine tools; and compressors for refrigeration.

U.S. industries that may be harmed are those in which (1) U.S. exports to the EC are occasional; (2) there is not a significant EC presence, either in market share or in direct investment; and (3) there are not strong international standards, particularly those of the International Standards Organization. Small U.S. exporters with either occasional sales or small market share and without a significant EC presence are most likely to abandon the EC market, as the costs of redesign and certification and testing will reduce the profit on EC sales.

Trade associations, U.S. Government analysts, and corporate officials contacted to ascertain the probable effects that this directive would have on U.S. exporters felt that (1) those industries that did not have significant ISO standards coverage would have the most difficult time adjusting; (2) those firms with a significant EC presence would be able to make the adjustment to this directive without great costs; and (3) the certification and testing procedures developed and implemented by the EC would have the greatest effect on U.S. exporters of machinery to the EC.

Diversion of trade to the U.S. market

If third-country suppliers are hurt by this directive, there may be a diversion of their exports to the United States. The competitors for this market are numerous, but generally include Japan, Taiwan, Korea, etc.

U.S. investment and operating conditions in the EC

U.S. firms that have a presence in the EC and are familiar with EC safety standards have the potential to be better positioned to capture market from other non-EC suppliers, particularly from those in Japan, Korea, and Taiwan. Those U.S. industries with the greatest direct presence in the EC and/or that have the largest market penetration, especially in several member states, would benefit the most. The directive is expected to encourage future U.S. direct investment. First, U.S. firms with direct investments in the EC may have to increase capital expenditures in order to meet the standards set forth in the directive. Second, and to an unknown degree, U.S. firms with production facilities in the EC may switch sourcing of some parts from the United States to the EC in order to obtain components that conform to the directive. In switching sources of supply, some U.S. firms may directly invest in their new EC suppliers. The extent to which this will be done is largely dependent on how the certification and testing directive is defined and implemented. Other U.S. firms that use U.S. components in products assembled or produced in the EC may shift from U.S. suppliers to EC suppliers to assure conformity to this directive. Some U.S. exporters will decide to license their product for production by EC manufacturers.

[87] Florence Nicolas and Jacques Repassard, *Common Stardards for Enterprises*, (Luxembourg: the Commissions of the European Communities [1988]), p.49.
[88] Statement of Mr. John Farnell, Commission of the European Communities, Directorate General for Internal Market and Industry Affairs to the U.S. Chamber of Commerce, Washington, D.C., Apr. 27, 1989.

U.S. Industry Response

In the face of such standards barriers, U.S. firms may react as have EC producers to EC internal standards barriers in the woodworking industry. These reactions include (1) to not carry out adaptation investment and, therefore, to abandon exporting; (2) to adapt to the standard and pass on the full cost of the price increase to the customer (this occurred among manufacturers of special machines); (3) to carry out product improvement and concentrate on exporting only certain types of machines; and (4) to develop new techniques in automation that minimize human involvement with the machine.

Views of Interested Parties

Mr. Steven Cooney, Director of International Investment and Finance for the National Association of Manufacturers, noted in testimony before the USITC on April 11, 1989, that there is a requirement for consultation on new technologies in the machine safety directive. He stated that it could be fairly significant and could slow a U.S. company's ability to make its European facilities economically competitive.

Simple Pressure Vessels (Directive 87/404)

Background

The primary aim of this directive is to ensure a minimum level of safety throughout the EC for unfired simple pressure vessels. Furthermore, the harmonization of safety standards will also aid the free movement of such products. In addition, a universally recognized testing procedure and mark of conformity will prevent wasteful checks being carried out in each of the member states.

Anticipated Changes

This Council directive is aimed at harmonizing all laws related to unfired simple pressure vessels. Member states of the EC must adopt by January 1, 1990, measures to comply that would become effective July 1, 1990.

Possible Effects

U.S. exports to the EC

It is not known at this time whether this directive will be trade discriminatory. Because of the various products that make use of unfired simple pressure vessels, it is anticipated that U.S. exporters will be adversely affected by this directive in its present state, but probably not more so than other non-EC exporters. Several industries that make use of simple pressure vessels, such as the air-conditioning and refrigeration (heat-exchangers) industry, medical services (sterilizers) industry, and producers of all types of storage tanks that contain ductile metals, will probably be among those industries most affected by implementation of this directive.

It also is not clear which U.S. industries that make use of unfired simple pressure vessels will receive the most benefit because it cannot be ascertained which firms in which industries may be in conformity with the directive. Any U.S. exporter in the industries producing simple pressure vessels might benefit if its products are already in conformity with the directive. Exporters such as producers of certain air-conditioning equipment and medical-equipment suppliers that use simple pressure vessels will be very likely to benefit from advanced technology not readily found in all EC member nations or in all other nations producing simple pressure vessels. The reduction in the number of different standards within the EC will also make the EC a much more attractive market for all foreign producers.

Diversion of trade to the U.S. market

The U.S. market is not expected to be a major recipient of third-country exports of simple pressure vessels as a result of implementation of this directive. A vast array of stringent technical standards and regulations are already in place in nations such as Germany (DIN), France (AFNOR), and the United Kingdom (BSI). In addition, it would be very difficult and expensive for third-country suppliers to modify their products to meet U.S. certification requirements.

U.S. investment and operating conditions in the EC

This directive is very likely to lead to greater investment, particularly for U.S. firms that now operate manufacturing facilities in the EC. Currently, the bulk of U.S. firms producing unfired simple pressure vessels rely on exports to serve the EC market. The high cost of establishing facilities in the EC to serve primarily national markets discouraged U.S. investment by small and medium sized firms. Such firms will benefit from access to a large, homogeneous market, which would result in lower operating cost and significant retooling savings. Historically, U.S. suppliers of simple pressure vessels have encountered various restrictive standards when exporting their products to the EC. Several industry spokesmen indicated that local-content requirements (e.g., steel) hindered further penetration of the European market. These restrictions have led to a surge in joint-venture or licensing agreements with other European firms.

U.S. Industry Response

Though simple pressure vessels span a multitude of different industries and products, all associations, firms, and individuals surveyed

indicated that this directive was likely to have a significant impact on their products. Nearly everyone surveyed indicated that the present EC definition of a simple pressure vessel was too broad and would require further refinement.

Several of the larger associations contacted indicated that they had established special member committees to monitor and to work with such other organizations as the EC Committee of the American Chamber of Commerce in Belgium, to express their concerns on issues affecting both U.S. exporters and investors.

Views of Interested Parties

No formal submissions were received.

Materials in Contact With Food (Directive (87) 239)

Background

This directive amends proposal No. (86) 90 and directive 76/893, citing the need of European consumers to obtain precise information on the intended use of materials in contact with foodstuffs. In addition, this directive appears to be "umbrella" legislation that provides for the development of specific directives that would establish new product criteria and/or standards related to a variety of industries, such as ceramics, glass, and plastics. One such directive lays down rules for testing the migration of plastics constituents in contact with foodstuffs.

Anticipated Changes

Directive (87) 239 has been adopted, with implementation scheduled 36 months after notification of approval. Several articles of directive 76/893 will be changed. The principal changes are: (1) mandatory consultation with the Scientific Committee for Food whenever questions concerning health implications are involved; (2) mandatory disclosure by all EC member countries of the intended use of materials and articles in contact with foodstuffs; and (3) mandatory prohibition of trade in and use of materials and articles which do not comply with the provisions of this proposed directive.

Possible Effects

U.S. exports to the EC

As a result of a proposed directive, one segment of the ceramic tableware industry—manufacturers of commercial tableware—indicated that proposed lead-release standards stricter than those in the United States might restrict exports of these products to the EC from non-EC suppliers. In addition, the proposed labeling requirements for materials and articles not already in contact with foodstuffs are considered to be a problem since the intent and meaning of these requirements are unclear. In general, article 3 of this directive appears to provide opportunity for the EC to adopt a variety of standards related to articles listed in annex I that may conflict with U.S. standards.

Diversion of trade to the U.S. market

In addition to more stringent lead standards imposed by the EC, making exporting to the EC more difficult for non-EC suppliers, certain EC countries, such as Italy, Spain, and Portugal, may also find meeting these lead-release standards difficult. Suppliers unable to meet labeling and lead-release requirements may turn to the United States as a market for their exports. Historically, certain suppliers (e.g., firms in China, Mexico, and Italy) have had problems meeting the U.S. standard; the imposition of a more stringent requirement in the EC would be likely to force these suppliers and others that would fail to satisfy the EC standards to seek other markets for their merchandise. As the largest market for these items, the United States would be a likely target for such exports.

U.S. investment and operating conditions in the EC

U.S. investment in the EC is not known to be adversely affected by this directive, nor is it known to affect U.S. business operating conditions in the EC. However, it is noted that industry and association sources contacted have not reviewed this issue to assess its impact, if any.

U.S. Industry Response

This directive is quite broad in coverage and has been noted by one industry as potentially harmful to this industry's interests. Nearly all U.S. industry representatives and associations contacted expressed little knowledge of the EC integration effort and its impact on their industries and had no knowledge of this specific directive. These industries are, however, interested in pursuing this issue further.

The commercial tableware industry opposes the implementation of this directive and cites the potential detrimental impact on U.S. industry of the proposed stricter lead-release requirement and the unclear labeling guidelines. Other industries have yet to form an opinion of this directive and its impact on operations.

Views of Interested Parties

No formal submissions were received.

Noise Emissions From Excavators (Directive 86/662)

Background

The EC has made an effort to abate pollution, including noise pollution. The 1973 and 1977 EC Action Programmes regarding environment and the noise nuisance problems and the disparity between member states regarding sound-emission standards, led to the adoption of this standard.

Anticipated Changes

Directive 86/662, implemented December 29, 1988, prescribes harmonized noise- and sound-level requirements that each category of equipment must satisfy—this is an extension to Directive 84/532, which addresses procedures for EC type-approval verification for construction plants and equipment. The directive further authorizes the creation of an EC standards-certifying board for construction equipment.

Possible Effects

U.S. exports to the EC

U.S. exports of the products affected by this directive were more than $700 million in 1988, accounting for 28 percent of the EC market. Other major competitors in Europe were Italy, Japan, West Germany, Sweden, and the United Kingdom. The proposed directive does not differ significantly from international standards already followed by the majority of the big U.S. manufacturers. Thus, the directive is unlikely to require more than minor changes in existing U.S. machinery exports to the EC. The directive is "performance oriented," however, and could either require simple retrofit or basic manufacturing changes. No procedural problems are anticipated unless certifying bodies in Europe are authorized to deny access to machinery not meeting standards perceived (perhaps differently) by each member. As far as is presently known, the U.S. manufacturers will either be allowed to (1) self-certify their product to meet EC standards, or (2) the unit will be subject to inspection and accreditation by an as-of-yet-undetermined third-party body within the EC.

Diversion of trade to the U.S. market

Any major third country suppliers which may be hurt by EC regulations have already established a position in the U.S. construction equipment market, which is mature and well-penetrated by imports. Therefore, it is not likely that substantial quantities of excavators would be diverted to the U.S. market.

U.S. investment and operating conditions in the EC

Most of the major U.S. manufacturers of construction equipment have long-standing capital and plant investment in the EC (estimated by Government sources at $1.17 billion). This directive is not expected to have any significant effect on current or future investment in the EC.

The U.S. industry has both longstanding operations in the EC and representatives who coordinate policy with the EC standards committee through their European counterparts at CECE (the Committee for European Construction Equipment). U.S. business operating conditions in the EC will continue much as before.

U.S. Industry Response

The U.S. construction-equipment industry does not seem unduly concerned. They are adopting a wait-and-see attitude. Most companies contacted believe that their machinery can be easily adapted to EC standards, which are assumed to follow ISO standards (the internationally accepted standards) already followed by many major U.S. firms.

U.S. construction-equipment manufacturers are continuing to monitor the implementation of the directive, as the method for certifying noise standard harmonization has not yet been finalized. The U.S. manufacturers who do not have operations in Europe but export to the EC will either retrofit their machinery or change their base manufacturing processes in order to comply with the directive (whichever is most cost effective for them). Those U.S. manufacturers who have plants in the EC already produce for the European market and are used to producing to specifications for at least 12 different EC countries. In some respects, U.S. industry sources explained, harmonization for them will actually be a blessing.

Views of Interested Parties

No formal submissions were received.

Noise Emissions From Household Electrical Appliances (Directive 86/594)

Background

Environmental programs in the EC highlighted the importance of the problem of noise and, in particular, the need to take action with regard to the source of noise.

Anticipated Changes

The directive, which is scheduled for implementation on December 4, 1989, would

require that all manufacturers and exporters of household appliances would have to disclose the level of noise emitted by these products. There is no known previous EC legislation on labeling household appliances regarding noise emissions or international standards.

Possible Effects

U.S. exports to the EC

As this directive does not set noise levels but only requires labeling, minimal effects on trade are expected. In order to comply with the directive, it is understood by U.S. industry officials that all manufacturers and exporters of household appliances would have to disclose the level of noise emitted by these products. The level of noise is to be measured by a standardized testing method and statistical samples will be taken to verify declared noise levels. U.S. firms consider this directive only as a minor "impediment to free trade," and feel that the noise level of their products are probably lower than those of European producers. Testing methods are not set forth in the directive but could pose a problem for U.S. firms.

Although industry sources estimate that the U.S. share of the EC market for these appliances is less than 1 percent, sales by U.S. firms amounted to nearly $1.1 billion in 1988. U.S. suppliers generally service the EC market from U.S. subsidiaries in Europe. The main competitors in Europe are Sweden, the Netherlands, Italy, France, and West Germany.

Diversion of trade to the U.S. market

Since the directive applies to all producers and since products are generally homogeneous in regard to noise emission, no suppliers are to expected to suffer adverse effects from this directive. Therefore, diversion of third-country exports to the United States is not anticipated at this time.

U.S. investment and operating conditions in the EC

Industry officials feel that there will be increased U.S. investment in the EC but not because of the noise-emission-level directive. The possibility of significant trade barriers being enacted before the 1992 transformation of the European market, and not just enactment of labeling requirements, is a major concern of industry. U.S. firms believe that a physical presence in the EC would negate some of the adverse effects of any trade barriers. Most of the major manufacturers of household appliances do not have manufacturing facilities in the EC. There are possibilities of more joint ventures, mergers, or acquisitions between U.S. and EC firms, but probably not as a result of this directive.

U.S. Industry Response

No known action has been taken by the U.S. industry in response to the directive, and industry representatives contacted do not believe any is needed except for adding the labels.

Most industry officials contacted told the USITC that, although it applies to all trading partners and conditions are likely to remain the same in relative terms, the directive is still another impediment to free trade. One industry official stated that rumors abound in Europe that Canada and the United States will be discriminated against by the way this directive is implemented. No other U.S. industry official contacted had heard this rumor.

Views of Interested Parties

No formal submissions were received.

Tar Content of Cigarettes (Directive (87) 720)

Background

The directive indicates that differences between laws, regulations, and administrative provisions of the member states on the limitation of the maximum tar content of cigarettes are likely to constitute barriers to trade and to impede the establishment and operation of the internal market. Accordingly, the directive requires that those obstacles be eliminated and the marketing and free movement of cigarettes made subject to uniform rules concerning maximum tar content, which take due account of public protection.

Anticipated Changes

It is unknown what specific laws are to be changed. However, member states will be required to comply with uniform EC rules relating to the maximum tar content of cigarettes. The tar yield of cigarettes marketed in the member states is not to be greater than 15 mg. on December 31, 1992, and 12 mg. on December 31, 1995. The directive is still a proposal. It is slated to be implemented 18 months after notification of approval.

Possible Effects

U.S. exports to the EC

The intent of the directive is to harmonize rules affecting the labeling of cigarettes. Cigarettes from all sources will be subject to the same maximum-tar-content rules.

In 1987, total U.S. exports of cigarettes amounted to about $2.0 billion and U.S. exports to the EC were valued at about $601 million. Belgium-Luxembourg accounted for 96 percent

of the value of total U.S. cigarette exports to the EC. Trade contacts report that a substantial amount of these U.S. exports are subsequently transshipped to other markets outside of Europe, and that direct U.S. exports of cigarettes to the EC (other than those that are transshipped) account for a very small portion of the EC market (due to a 90-percent ad valorem common customs tariff rate). However, it is estimated that U.S. manufacturers account for more than 30 percent of the EC market for cigarettes if U.S. manufacturing subsidiaries outside the United States are included as suppliers. Major suppliers to the European market include the United Kingdom, West Germany, France, Switzerland, Italy, and Spain. The EC market is believed to be serviced primarily through U.S. subsidiaries in the EC.

Diversion of trade to the U.S. market

Trade sources indicate it is unlikely that any major third-country supplier will be hurt; therefore, a diversion of exports to the U.S. market is not expected. Total U.S. imports of cigarettes amounted to $22 million in 1987.

U.S. investment and operating conditions in the EC

Trade contacts report U.S. firms have substantial investments in Europe; however, the level of this investment is unknown. It is unlikely that the directive will significantly either existing or future investment in the EC.

U.S. Industry Response

Industry contacts have not indicated any planned response to the directive at this time.

Views of Interested Parties

Philip Morris Management Corp. and R. J. Reynolds Tobacco Co. provided comments to the USITC's staff regarding the EC's proposed tar levels. The companies are opposed to any restriction on their right to market historically-lawful tobacco products in the EC. They believe the proposal to be arbitrary and discriminatory in view of the fact that it is directed exclusively at manufactured cigarettes (of which U.S. manufacturers have more than a 30-percent market share in the EC) and does not require equivalent limitations on any other tobacco products. Philip Morris believes the proposal is without substantive scientific foundation and that the proposal could result in changes in consumers' smoking practices. R.J. Reynolds stated that the proposal totally ignores consumers' preferences.

Liability for Defective Products (Directive 85/374)

Background

Unlike the United States, most EC member states have declined to provide the consumer with legal recourse against the producer of a defective product unless the consumer can prove that the producer has been negligent. As stated in the directive preamble, the EC found that a need existed to institute a form of strict liability, in order to provide adequate protection for consumers who are faced with the risks of using modern technological products. The EC Commission has also indicated that it also intends to issue a proposal on the civil liability for defective services.[89]

Anticipated Changes

Directive 85/374, which has an implementation deadline of July 30, 1988, broadens EC liability law in several respects. Most importantly, a consumer need not prove that a producer was negligent in order to win a judgment for damages resulting from the use of a defective product.[90] Moreover, the consumer can also bring suit against the importer of a defective product, and, if the producer cannot be identified, against the supplier of the product. The entities responsible for the product are jointly and severally liable. A producer cannot escape liability through contractual or other limitations. The producer remains liable for 10 years after its product is put into circulation, although the consumer must sue within 3 years of the date on which he or she became aware or should have known of the defect and the identity of the producer. Finally, member states may pass implementing legislation that is more stringent than the directive, in that the legislation may cover more products and exclude some defenses provided in the directive.

The directive sets certain limitations. A product is defective only if it is unsafe when used as can reasonably be expected. The directive covers only movable products and electricity and does not cover primary agricultural products or game. The consumer may collect damages only

[89] Commission of the European Communities, *Fourth Progress Report of the Commission to the Council and the European Parliament Concerning Implementation of the Commission's White Paper on Completion of the Internal Market*, COM (89) 311, (Brussels, June 20, 1989), par. 38.

[90] The EC Commission has decided to open infringement proceedings against nine of the member states for failure to properly implement the directive. The EC Commission is also opening infringement procedures against two of the three member states (Greece, Italy and the United Kingdom) that did implement the directive, because Italy and the United Kingdom enacted laws that the EC Commission considers to be not in conformance with the directive. EC Commission press release IP (88) 877 (Dec. 22, 1988).

for death, injury, and damage to property worth more than 500 ECU and ordinarily intended or used mainly for private consumption. Damage to commercial property is not covered, nor is injury or damage arising from certain nuclear accidents. The producer can reduce or escape liability by the use of certain defenses, such as a showing that the consumer was partly at fault or that the defect was due to compliance with mandatory regulations issued by a public authority. A member state may put a cap on liability, as long as the cap is not lower than 70 million ECU.

Possible Effects

U.S. exports to the EC

U.S. producers already face similar liability in the U.S. legal system, which, with its more readily available jury trials and larger awards, may be harder on producers than would be the EC system.[91] Consequently, the directive may not significantly deter U.S. exports. Nevertheless, the directive may discourage some U.S. exporters who were accustomed to the lower risks of selling in the EC. Because of the directive's limited coverage, this is more likely to be true of products intended for private rather than commercial use. Further, exporters may be discouraged because, if they seek to minimize unreasonable use of a product by affixing warning labels, they must figure out how to write a label that can be understood in a multilingual and multicultural market. The State Department indicates that although the directive is thought to be logical and nondiscriminatory in nature, it could cause a change in buying patterns and increase purchases within the EC to shift liability. In this way, the directive may adversely affect U.S. exporters. Importers and distributors, who can be held liable for defective products, have an incentive to deal with EC producers rather than non-EC producers because a consumer may find it so hard to collect a judgment from a non-EC producer that suing the EC importer or distributor is easier. The above would be equally true for non-U.S. exports to the EC; in that sense the directive does not discriminate against U.S. exports.

Diversion of trade to the U.S. market

The directive could prompt some diversion of third country exports to the U.S. market by exporters concerned about increased risks. The likelihood of such diversion, however, is reduced by the fact that product liability is also recognized by U.S. law.

U.S. investment and operating conditions in the EC

U.S. businesses will need a greater awareness of the potential harm their products can cause and to monitor the course of EC judicial decisions carefully. Small companies with less insurance coverage may be particularly at risk. Future U.S. investment in the EC could be discouraged by the increased risk of legal action, increased insurance costs, the need for more quality controls and recordkeeping, and the need to seek indemnities from component suppliers.

U.S. Industry Response

U.S. industry has indicated that they will need to have a greater understanding of the directive in order to respond.

Views of Interested Parties

No formal submissions were received.

[91] See, for example, G. Whitehead, "Product Liability and European Integration in Light of the EEC Strict Liability Directive," paper presented at *Europe 1992: Implications and Strategic Options for American Business*, conference sponsored by the Center for International Business and Trade, School of Business, Georgetown University, and Hudson Research International, Ltd. (Dec. 9, 1988).

CHAPTER 7
CUSTOMS CONTROLS

CONTENTS

Chapter 7

Customs Controls

Because of the importance of the United States-EC trading relationship, the United States and U.S. firms have a strong interest in all aspects of customs regulation and trade-policy development. The elimination of border controls and the simplification of customs procedures will ease trade with and among the member states, but other measures (including some not contained in the White Paper) may have the effect of restricting U.S. exports.[1]

Background

The "customs" aspects of the 1992 integration of the European Community into a single market are diverse in their focus and effects. An accurate evaluation of their significance depends on the perspective from which they are viewed. On the one hand, the customs directives[2] represent the predictable and essential continuation of previous work undertaken under the EEC Treaty to approximate member state legislation. On the other hand, they constitute a novel effort to cede basic functions now controlled by national governmental authorities—and viewed as critical to the collection of tax revenues—to a supranational entity. The latter aspect has led many people to believe that the directives might never be made fully effective in all member states.

If implemented as intended by the EC Commission, these directives would provide visible proof of this integration to both member-state nationals (referred to below as "EC nationals") and persons from outside the EC, and would simplify the process of moving goods in trade in the EC. To accompany the substantive measures, the EC has also adopted a European Community driver's license, a flag (a blue rectangle with a circle of 12 gold stars) and an anthem (the "Ode to Joy" from Beethoven's Ninth Symphony).[3]

For purposes of this study, the term "customs" is employed in a broader sense more commonly understood in the EC than is the case in the United States. Thus, the subject matter of this section involves three areas—namely, freedom of movement forgoods, freedom of movement for persons, and generally applicable standards for workplace health and safety. In much of the literature dealing with the 1992 process, the first two of these areas are frequently treated as being related, and the third one represents social policy changes being undertaken to lend a human side to European economic integration.

As with other measures to achieve the internal market laid out by the White Paper, these customs directives can be fully evaluated only in the broad context of all activities on EC institutions. These measures are designed to fill any gaps left by the treaty of Rome and previous legislation, not to operate in isolation. Also they should be viewed in comparison with counterpart measures employed by the United States, Japan, or other trading partners as well as with past EC practices, especially in the context of developing responses to remedy any perceived adverse impact.

Accordingly, it must be emphasized that the directives covered by the White Paper are not the only actions being taken at the EC level to affect non-EC imports. These "non-1992" measures must be weighed in contract negotiations and business planning, as well as in conducting the Uruguay Round talks. For example, the EC's administration of is antidumping program[4] must be monitored and the potential effects of actions taken (not only to end the unfair practice but also to prevent circumvention and deflections of trade) must be kept under constant inspection. The EC Commission, acting under new anticircumvention authority given it in 1987,[5] has recently adopted numerous measures directed at preventing circumvention by Japanese firms whose products are subject to additional duties.[6]

[1] Martin E. Elling, *The European Community: Its Structure and Development*, Congressional Research Service Report for Congress (August 1988), p. CRS-1.
[2] In this section of the report, the term "directive" is used to refer to directives adopted by the Council, proposed directives presented by the EC Commission, and proposed or adopted regulations of either entity, unless expressly indicated to the contrary.
[3] 19 *EC Bulletin* No. 4, pp. 51 to 52 (1986).

[4] Under EC law, protective measures may be instituted against non-EC countries' exports if their prices are below the "normal value" or the goods in the EC, if the dumped products cause or threaten to cause material injury to an EC industry or materially retard the establishment thereof (on an EC-wide basis), and if the interests of the EC justify intervention. The EC Commission is responsible for all aspects of dumping investigations; it may order either provisional or definitive antidumping duties on the subject imports. In the alternative, the EC Commission may accept an undertaking from the exporters under which exports are terminated or prices revised in such a manner that either the dumping margin or the injurious effects cease.
[5] Council regulation (EEC) No. 1761/87, 30 *Official Journal of the European Community (O.J.)* No. L 167, p. 9 (1987), amending Council reg. (EEC) No. 2176/84 27 *O.J.* No. L 227, p. 35 (1984), the latter concerning the EC's protection against dumped or subsidized imports from nonmember states.
[6] Under the new regulation, definitive antidumping duties can be imposed on goods shipped to the EC in unfinished form (i.e., parts, components, or materials) for assembly there if (1) the EC assembly is carried out by a party associated with or related to the exporting manufacturer of the finished product, (2) that operation began or was substantially increased subsequent to the institution of the dumping investigation, and (3) the value of targeted-country components or materials exceeds the value of all nontargeted content by at least 50 percent. Such parts or materials suitable for production into the article subject to dumping duties are subject to the duties; they are released into free circulation in the EC without payment only upon a showing that they have been utilized to make other products. See art. 13(10) of Council reg. (EEC) No. 2176/84 and Council dir. 79/623/EEC, 22 *O.J.* No. L 179 (1979), p. 32.

These measures, along with related "undertakings," may have adverse effects on U.S. suppliers (selling to Japanese firms) or competitors (attempting to sell like products in the EC) and might ultimately force added U.S. productive investment in the EC—perhaps at the cost of domestic employment. Because the arrangements with Japan are not generally published, it is difficult for U.S. firms to take them into account in directing their activities.[7]

Similarly, country-of-origin rules[8] exemplify types of ordinary customs regulations that can be employed or modified to affect the flow of trade, although no origin changes are formally involved in the integration process.[9] The recent and sudden decision by the EC to treat semiconductors as having EC origin only if diffusion occurs in the EC could have a greater effect on U.S. interests than many "1992 directives." Because the diffusion process is generally the most complex and costly step in chip manufacture, investment could be diverted from the United States to the EC if firms wish to obtain EC origin. Likewise, a decision to treat photocopiers assembled in the United States using principally Japanese components as having Japanese rather than U.S. origin meant that such goods would be subject to dumping duties—and has given rise to fears that the assembly could shift to the EC. If such a principle is used as a precedent, U.S. interests may be harmed. Even when a particular origin ruling is simply being changed, perhaps to the same standard employed by other countries for the subject product (as is the case with semiconductors), the method used to accomplish changes may have a significant impact. This is especially true when the new rule is not available for public comment or is otherwise announced in advance of implementation.

Finally, attention must be given to the related matter of local content (whether set in terms of components used, value added, or investment required). Rules of origin or of preference often contain a value component, which, if set sufficiently high, can compel operations to be located in a particular country. Specified levels of local content are at times mandated by a member state as a condition of investment therein. The EC acknowledges that such standards can restrict investment and may violate the national-treatment principle of the GATT, though such standards may be appropriate in undertakings or in the administration of quantitative restrictions.[10] Although origin clearly need not be assigned on a content basis, the EC employs processing criteria to many products for which changes in classification are not possible, and the type of process specified in list B for a product may operate as a local-content standard. Because the origin determination may also have consequences for nonduty purposes (such as government procurement), it can be the key motivation for firms to establish productive capacity in the EC, or may serve with noncustoms concerns to influence firms to take such actions.

Free Movement of Goods

Background

Historical framework

One of the primary objectives of the 1958 EEC Treaty was the achievement of a customs union, within which articles in trade would face few or no barriers to movement. Accordingly, article 2 of the EEC Treaty required the

[7] See Van Gerven, "New Anti-Circumvention Rules in EEC Anti Dumping Law," 22 *The International Lawyer*, pp. 809, 828 (Fall 1988). The undertakings entered into Japan and the EC Commission have attempted to address the "screwdriver plant" problem to prevent avoidance of additional duties through EC-based assembly of imported components. Such arrangements now apply to electronic typewriters and scales, hydraulic excavators, photocopiers, and other products; they often require that a specified level of EC content be achieved to obtain treatment as "EC goods," thereby avoiding the additional duties. Although it is generally stated by the EC Commission that nontargeted-country content, rather than EC content, may be employed by the targeted country's firms, in practice the latter are believed to be raising the level of EC content instead, since that practice not only permits easier avoidance of the additional duties but also permits ordinary duties to be assessed only on the reduced level of non-EC content. Thus, for example, U.S. subcontractors supplying components to the targeted country's firms could lose such sales to EC competitors.

[8] Country-of-origin rules are utilized to determine the source of goods not wholly derived, produced, or manufactured in one country, so that appropriate duties may be assessed, trade statistics recorded, etc. The EC's nonpreferential (most-favored-nation) rule assigns origin to ". . . the country in which the last substantial process or operation that is economically justified was performed, having been carried out in an undertaking equipped for the purpose, and resulting in the manufacture of a new product or representing an important stage of manufacture." Council reg. No. 802/68 of June 27, 1968, as amended, *O.J.* No. L 148, p. 1 (June 28, 1968). The rule is usually described as a "substantial transformation" (ST) standard, the same criterion utilized by the United States. However, in the EC the application of the standard is codified in a rather complex manner to ensure particular results for specific products. That is, ST is accomplished by conducting processing on imported materials so as to achieve a change in their tariff classification, except as provided in exceptions lists A (additional requirements when such a change of classification is deemed insufficient) and B (operations sufficient to confer origin when no change of classification occurs). See U.S. International Trade Commission, *The Impact of Rules of Origin on U.S. Imports and Exports: Report to the President on Inv. No. 332-192*, USITC Publication No. 1695, May 1985, p. 39 et seq.

[9] USITC staff meeting with an official of DG XXI, EC Commission, Apr. 20, 1989.

[10] USITC staff meeting with official of DG I, EC Commission, Apr. 21, 1989.

signatories to end, as between the members, the imposition of customs duties and quantitative restrictions (and other measures with the "equivalent effect") and to adopt a common customs tariff and commercial policy with respect to trade from third countries. This common market, under article 8 EEC, was to be completed by the end of a 12-year transition period. More detail as to these goals was set forth in title I of part 2 of the EEC Treaty, entitled "Free Movement of Goods." In spite of the staged introduction of the new obligations and detailed requirements for EC Commission reports and Council findings, movement toward the open market was slow, and the adoption of the common customs tariff directed by article 9 EEC was not complete until 1968.

This customs union was to apply to goods wholly produced in the member states, to goods produced by third countries in free circulation in the EC, and to goods covered by particular preferential programs due to be phased out over time (especially arrangements with former colonies). Under article 10, products of third countries, after all duties and taxes have been paid, all formalities met (upon original importation into a member state), and no drawback of customs duties claimed, are deemed to be in free circulation and can move among the member states without further payments of ordinary customs duties.

Although the EEC Treaty mandated these broad measures as the cornerstones of the customs union, it left much trade-related authority (such as the right to enter into bilateral and multilateral agreements compatible with the EEC Treaty) to the members' governments. Other issues were left to be treated by the Council and the EC Commission in regulations and directives, with the latter subject to potentially varying member-state implementation. Thus, not only was no method of developing an EC trade policy established, but also much of the customs area—substantive matters and administrative procedures—remained under country control.

The Benelux union

After examining their own interests and objectives, three EC member states—Belgium, the Netherlands, and Luxembourg—established an economic union, unifying both their customs-trade programs and their economic policymaking.[11] This union then proceeded to make special agreements with the adjoining EC member states, none conflicting with the EEC Treaty, to simplify trade between the three-country union and any party to such an agreement.

[11] Benelux Union Treaty of Feb. 3, 1958, and Convention of Apr. 11, 1960, p. 8, *European Yearbook* (1960), p. 175, as amended by Protocol of Aug. 18, 1982.

The advantages that accrued and the ability of the three union members to carry on the agreed arrangement may in part have encouraged the EC as a whole to proceed with efforts regarding the internal market. The three countries have also acted as one in other areas, for example in the issuance to their nationals of a Benelux passport. Again, their measures outside the usual economic sector have seemed to inspire broader action by the EC, such as the adoption (being staged into effect over several years) of a European Community passport for nationals of all 12 member states. However, some of the issues that could be resolved fairly easily for the Benelux countries pose greater problems for the EC as a whole.

EC customs regulation

Even with the EC's common customs tariff, it was only in 1984 that a detailed EC-wide system of obtaining duty reliefs (very similar to U.S. temporary duty suspension legislation) was made effective.[12] Directives providing for exemptions from value-added tax and from various taxes on individuals' personal property, whenever covered goods are taken permanently from one member state (after appropriate taxes have already been collected) into another, also became binding in 1984.[13] Also, the effort to provide tax exemptions for means of transport moving temporarily from one member state to another (directive 83/182 of Mar. 28, 1983, *O.J.* No. L 105, p. 59 (Apr. 23, 1983), eff. as of Jan. 1, 1984) and for fuel in the tanks of such vehicles (dir. 83/127 of Mar. 28, 1983, *O.J.* No. L 91, p. 28 (Apr. 9, 1983)) began. These measures, already amended since their adoption, again require amendment to permit achievement of the internal market.

The publication of the White Paper added considerable impetus to the EC's effort to eliminate customs barriers and achieve harmonization of laws and documentation. Until the planned 1992 abolition of customs formalities at internal EC frontiers, both travelers and goods are subject to customs inspection and documentation requirements, other related procedures, and resultant costs and delays when moving within the EC. These formalities generally apply in both the country of departure and the country of destination. These procedures pertain to products of the member states and to products of other countries in free circulation in the EC.

[12] Regulation 918/83 of Mar. 28, 1983, *O.J.* No. L 105, p. 1 (Apr. 23, 1983), effective as of July 1, 1984.
[13] See, respectively, directive 83/181 of Mar. 28, 1983, *O.J.* No. L 105, p. 38 (Apr. 23, 1983), effective as of July 1, 1984, and directive 83/183 of the same date, *O.J.* No. L 105, p. 64 (Apr. 23, 1983), effective as of Jan. 1, 1984.

In addition, 12 differing sets of customs procedures are employed by the member states, impeding trade for EC nationals and firms as well as those of third countries. As many as 170 customs forms have been used in the member states, with numerous copies required to be submitted on each side of every border crossing. Costs to firms—especially small ones—of complying with customs formalities are estimated at 7-1/2 billion ECU for administrative costs and at 415 to 830 million ECU for delay-related costs; costs to governments are put at 500 million to 1 billion ECU.[14] Rough estimates of lost trade indicate that abolishing border formalities could increase trade by from 3/4 percent to 3 percent, or from 3.75 billion to 15 billion ECU, and reduce the cost of goods by up to 7 percent. The member states have also maintained separate quantitative restraints on third-country goods and determined the amount of bond to be posted, inspections done, and other potentially conflicting or duplicative administrative criteria. Legal findings issued in one member state as to a shipment have not always been accepted fully and automatically in another member state, and certificates of authenticity and other documents have been subject to challenges. Many EC pronouncements have held that these separate administrative procedures must be abolished if truly free trade is to be attained.

One regulation not always considered in analyses of the so-called 1992 program, but commonly viewed as important to the internal market, was actually adopted on Feb. 18, 1985. The measure, Council regulation No. 678/85 (*O.J.* No. L 79, p. 1 (Mar. 21, 1985)), created the widely applicable Single Administrative Document (SAD)—the new customs form to supplant the 150 or more forms now in use in the EC—and entered into force on July 1, 1988. This form was intended to be used for intra-EC trade on an interim basis until border formalities can be ended, and is to be used from 1988 onward for trade with third countries. The SAD applies to all entries of goods into a member state, to the dispatch of goods, and to goods under internal EC transit procedures. The SAD has already been described by government officials and private parties alike as a significant benefit in conducting trade with EC member states and transporting goods in free circulation within the EC.

[14] See Ernst and Whinney, *Cost of Non-Europe: Border-Related Controls and Administrative Formalities*, vol. 4, p. 1; see also the *Patterson Report to the European Parliament's Economic and Monetary Committee*, Doc. A-2 50/89/B, May 31, 1985. The Ernst and Whinney research indicates that up to 85,000 customs brokers jobs, creating about 1-1/2 million ECU in fees, may be lost in the EC (p. 22).

Related issues

The simplification of customs documentation, though important, has proven to be more easily accepted by the member states than the far-reaching abolition of border controls contemplated for 1993. The rationale for maintaining these measures has rested on two principal factors—namely, the member states' desire to retain as much control over trade and economic policy as possible, in view of national interests; and fears that EC-level customs measures would result in significant problems. Border controls exist to ensure enforcement of national policies on such matters as control on capital movements and immigration, health and safety regulations, taxation of goods, collection of trade statistics, control of drugs and terrorism, and management of the EC Common Agricultural Policy with respect to monetary compensation amounts. Because most of these have traditionally been wholly within the authority of member governments, harmonization is difficult; concern exists as to the adequacy of measures applicable only at external frontiers. Moreover, border formalities must be reduced or eliminated at the same time as the harmonization of taxation measures (particularly on value-added tax) and other trade-related programs, as described in this report's chapter on taxation.

Despite their usefulness to governments, however, these same controls also serve to inhibit the economic activities of persons crossing frontiers. This favor is a special burden in Western Europe, where many people live in border areas and regularly cross frontiers to visit, farm, or work. The White Paper asserted that the removal of border controls is essential to the completion of the internal market, because these controls contribute directly to the costs and disadvantages of a divided market and hinder achievement of economies of scale. Opinions appear to differ as to the likelihood of reaching the White Paper's ambitious goals; because of legislative procedures and schedules, many of the measures may not be implemented at the member-state level by January 1, 1993.[15]

Anticipated Changes

Many directives under review in this investigation deal directly with customs matters or are effectively enforced by customs officers. The six measures considered herein relate to the simplification of border controls within the EC and the effort to attain completely free movement among EC countries. Four measures are concerned with facilitating the free movement of

[15] Elling, *The European Community: Its Structure and Development*, CRS Report for Congress (August 1988), pp. CRS-32 through CRS-36.

goods. Two directives serve to promote the progressive reduction of customs border formalities applicable to member-state nationals. The proposals are in some cases interim measures, intended to ease the transition to completely open borders expected in January 1993. To an extent some provisions are modeled after or supplementary to the terms of international agreements to which the EC is a party, including the 1975 customs convention on the international transport of goods (discussed below).

One pair of Council regulations, Nos. 1900/85 and 1901/85,[16] adopted on July 8, 1985, implement one of the White Paper proposals by requiring as a matter of EC law that standard forms be employed for particular customs transactions. The first such regulation created standard written import and export declarations for specified goods in trade with third countries or within the EC, essentially for goods not entered or exported under usual customs procedures, to be utilized after January 1, 1988. Thus, for example, goods being temporarily brought into the EC for exhibition or testing would be entered using a form IM, possibly supplemented by additional information supplied on a form IM/c.

Similarly, the second regulation made modifications in provisions of prior regulations covering the status and documentation of goods in EC transit under all of the various European Communities' treaties. Thus, the SAD was made applicable to shipments of goods under the European Coal and Steel Community Treaty, including goods temporarily imported. The information on the previously required forms will be obtained using the SAD, since their requirements have been incorporated into the latter.

A third regulation, No. 3690/86 of December 1, 1986 (*O.J.* No. L 341, p. 1 (Dec. 4, 1986)), attempted to fit the EC's new policy on frontier posts into the framework of the TIR [Transportation International Routier] Convention,[17] to which the European Communities have long been party. The Convention sets forth procedures for facilitating the movement among contracting parties of goods under seal and covered by customs carnets issued in the country of original exportation by domestically approved persons or entities. Under the TIR Convention, because the pertinent documents are issued in exporting countries, the subsequent importation into the second country (which is not the country of destination, as a rule occurs without further customs formalities, with the carnet serving as the entry document for the goods. The first time the second country's customs officials examine the documents is upon the exportation of the carnet goods to country three, a procedure ensuring that the carnet goods leave the country unchanged. If this third country were not the ultimate destination of the goods, their customs officials would also examine the relevant documents upon exportation.

Under the simplified customs system being adopted in the EC, however, in the interim phase, the customs officials at points of importation are given entire responsibility for administering all procedures of the country of entry, and border checks at points of exit are eliminated. As of 1993, even these checks at ports of entry are to be abolished. Thus, for the interim period, the regulation provides that the decisions and procedures carried out at points of entry are, for purposes of goods under TIR carnets, to be deemed as having been accomplished by the officials at the point of exit. For the final phase, obviously, the only necessary customs review would occur when carnet goods that have transited under the EC (such as to Austria or Switzerland) are exported to a third country. By that time the regulation would not be needed to achieve compliance with the TIR Convention.

A final measure, Council regulation No. 4283/88 of December 21, 1988,[18] abolishes all exit formalities at common borders for the interim stage and introduces common border points at points of entry. The document provides that officials at such entry points are to carry out necessary activities for the adjoining country under its rules and with the same legal force and effect as if done by its own customs officials. A single check on any person or vehicle crossing a border will be done in the country of entry, and information on the movement of people and goods will be shared by the member states concerned. Accordingly, duplication of procedures will for the most part be eliminated and clearances facilitated. The regulation is effective as of July 1, 1989.

By contrast, other EC Commission proposals in the customs area have yet to be approved by the Council, in part because of difficulties in developing EC-wide policies on trade-related matters but also because of the loss of member-state control over border crossings and procedures that the directives represent. Those proposals not yet adopted must be put into effect by each member state by national legislation, which will not likely be identical; thus, some small variations in customs procedures and administration will continue to exist.

One such proposal, designated (85) 224,[19] is

[16] See *O.J.* No. L 179 (July 11, 1985), pp. 4 and 6.
[17] Formally entitled the Customs Convention on the International Transport of Goods under Cover of TIR Carnets, with 30 annexes. Done at Geneva Nov. 14, 1975; entered into force Mar. 20, 1978; entry into force for the United States Mar. 18, 1982 (does not yet appear in published form in TIAS).

[18] *O.J.* No. L 382 (Dec. 31, 1988), p. 1.
[19] Adopted May 7, 1985, as an amendment to an earlier proposal, (84) 749.

described by the EC Commission in its explanatory memorandum to the Council as "a first step towards the abolition of all controls and formalities on citizens and to clarify certain provisions with a view to greater facilitation for those concerned" (*O.J.* No. C 47 (Feb. 19, 1985) p. 5). Its goal is to ease the formalities and customs controls—as well as delays—applicable to member-state nationals crossing common borders into another member state. Under existing procedures, individuals are often stopped for document verification at both the exit post and the point of entry at a given frontier crossing. EC citizens may, upon presentation of a valid identity card or passport, refuse to answer any customs or immigration-related questions at such checkpoints, but third country-nationals can be detained, unless clear public health or security concerns are evident.[20] A member-state national detained by customs officials unnecessarily can bring a claim for compensation under the laws of the country of occurrence. Apart from these persons, all other traffic through border points is routinely stopped to clear customs, often on both sides of a border. Although the more critical scrutiny is reserved for commercial shipments and carriers, private persons can still face lengthy delays at frontier crossings.

Under this proposal, a vehicle bearing officially issued green windshield discs would be able to clear customs at a slow speed without stopping, and its occupants and their accompanying baggage would all be deemed to meet criteria laid down in the various EC instruments. Spot checks could still be done when officials have cause to believe noncompliance exists. One or more separate lanes at border crossings would be reserved for such vehicles, and corresponding passage would be provided for persons showing EC identity documents and traveling on foot, bicycles, horses, and so on. More detailed security checks could still be carried out at airports, but ordinary border checkpoints would no longer be marked by signs saying "Customs" or "Douanes"; these signs would be replaced with signs stating the name of the country being entered and its status as an EC member. The overall goal is free movement for individuals with the lowest possible level of customs enforcement and administrative activities. The measure was to have entered into force on January 1, 1988; member states have implemented many of its provisions.

Possible Effects

U.S. exports to the EC

Useful data are unavailable for exports that would be affected by these directives, because they pertain to the movement of all goods (and persons) to and within the EC and thus potentially to all industries. If this group of directives is fully implemented, there will be a net trade liberalizing effect for all suppliers to the EC, including the United States, in the form of a significant reduction in and simplification of administrative formalities. Firms established in the EC, including third-country suppliers with EC subsidiaries that engage in intra-EC transport, will benefit along with any third-country exporters. Moreover, the adoption of the proposed directives would not appear to place a greater burden on non-EC countries than on EC countries or to discriminate among suppliers; thus, U.S. interests are not likely to be affected any more than those of other non-EC countries.

To the extent that the new procedures are simpler and are employed in trade with third countries, they should facilitate trading opportunities and customs procedures for all third-country suppliers and for firms transshipping goods through the EC (such as to Austria or Switzerland). The directives lower the financial costs of procedures and delays related to compliance with customs formalities, provide for the possibility of increased opportunities for trade, and reduce the costs of administering customs controls borne by government.

Although the directives and the resultant lower document preparation and transportation costs should positively affect all U.S. industries participating in EC trade, the Arrangement of Transportation of Freight and Cargo industry (SIC 4731) may accrue additional direct benefits and is currently reviewing its manufacturing and distribution strategies.

Diversion of trade to the U.S. market

Because no particular third-country suppliers should be significantly adversely affected by the directives, no exports should be diverted to the United States.

U.S. investment and operating conditions in the EC

To the extent that U.S. exporters have EC subsidiaries or engage in intra-EC trade, they will accrue benefits from these proposals; all exporters to a member country will be aided by the Single Administrative Document, the single customs form being used in all trade with the EC. When intra-EC border controls become administratively less complex than external border controls and external border controls are strengthened to compensate for the less stringent internal controls, firms in EC countries (and in EFTA countries benefiting from their special relationship with the EC) may acquire a comparative advantage over their non-EC counterparts in future EC trading activities. However, U.S. interests as a whole should not be

[20] See answer by Lord Cockfield to Written Question, Feb. 16, 1987, QXW1385/86 EN.

negatively affected compared with those of other similarly situated third-country exporters.

Overall, the directives should have a limited effect on existing or future U.S. investment in the EC, as they represent only a slight modification of transit procedures. The potential cost savings alone would not seem likely to induce the location or expansion of facilities, but would be a factor taken into account by firms—especially when a firm established in one EC member state considers whether to add operations in another.

U.S. business operating conditions in the EC should improve as a result of the directives because the administrative and resource costs of border-crossing will be reduced. Border delays and uncertainties are becoming increasingly relevant as the just-in-time concept of components management is gaining in importance. To the extent that the directives provide for document simplification and the elimination of one set of controls at each frontier crossing, there should be a slight positive effect on business operations. Given that there will be some costs associated with the transition and time required to become familiar with new procedures, there could be a small temporary adverse effect on U.S. business.

U.S. subsidiaries incorporated in the EC will profit from the standardized procedure as much as will purely European companies and given their lower transportation costs (compared with those of the parents) may be aided more than U.S. parents in competitive situations. U.S. subsidiaries who have already rationalized their EC operations should be well situated to benefit from customs simplification, perhaps to a greater extent than some EC competitors.

U.S. industry response

U.S. industries are unlikely to take new action solely in response to the directives; many of them have already come into force, with limited reaction, on at least an interim basis. Their combined effect thus far represents only a slight modification of transit procedures; and some cost reduction had also occurred.

Views of interested parties

To date there have been no representations or comments from interested parties, and no significant problems in this area have been discussed in the published literature. As noted above, customs simplification is widely viewed as a chief positive result of integration.

Free Movement of Persons

Background

Historical framework

As is the case with respect to goods, persons are afforded the right of free movement within the EC under title III of the EEC Treaty, but only if they are workers (arts. 48 to 51). All nationals of member states are afforded the right of establishment throughout the EC by article 52 of the EEC Treaty. That is to say, they are given "the right to take up and pursue activities as self-employed persons and to set and manage undertakings . . . under the conditions laid for its own nationals by the law of the country where such establishment is effected"—specifically, to provide services. This provision was originally planned to be implemented in progressive stages; in fact, only incremental measures were adopted by the EC and the member states until the issuance of significant decisions by the Court of Justice.[21] The member states support individuals' right to freedom of movement, but they are viewed as being reluctant to afford to EC institutions the authority to deal with non-economically related rights, out of concerns about national sovereignty.[22]

The restriction to workers of the EEC Treaty's right to move freely was a result of very different laws of the original six member states on the acquisition of nationality, based on special relationships with former colonies, fiscal reasons (to restrict the number of persons potentially eligible for social benefits), and fear of mass immigration. If the EEC Treaty had provided a broad right of free movement and freedom of residence, persons who gained nationality in a member state (presumably the one with the broadest standards) could then relocate to another, whether or not they were employed or self-supporting. Article 60(3) of the EEC Treaty did recognize a right to temporarily stay in another member state explicitly applicable to providers of services; following a ruling in the case *Luisi and Carbone*,[23] this right has been directly enforceable in member-state courts. However, the countries can control the duration of such visits and can in most cases deny the extension of social benefits or consumer services.

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[21] See, for example, case 33/74, van Binsbergen, [1974] *European Court Reports* (E.C.R.) 1299, which held that the right of establishment under art. 52 EEC is directly enforceable in courts of the member states without legislation.

[22] See note, "The Elimination of European Community Border Formalities," 27 *Virginia Journal of International Law*, pp. 369, 371 (Winter 1987).

[23] Joined cases 286/82 and 286/83, *Luisi and Carbone* v. *Ministero del Tesoro*, [1984] E.C.R. 395 held that since tourists receive services, which are to be provided freely, arts. 59 and 60 are held to apply to them and to prohibit restrictions such as currency payment limits. The holding built upon the earlier case 53/81, *Levin*, [1982] *E.C.R.* 1035, that individuals (including students, who traditionally faced tighter residency controls out of fears they may lack funds for their support) as actual or potential recipients of services have a right to free movement, without regard to their individual ability to pay, if the service activity is "effective and genuine."

Related issues

Various reports done or requested by the EC Commission over the last decade, including the White Paper, have recommended an expansion of the EEC Treaty's scope in the area of free movement of persons.[24] The uniform EC passport mentioned above was one of the measures adopted without great difficulty and is being phased in over periods of years in the different member states as earlier passports expire. The Council now must deal with measures for arms control, a general right of residence, immigration, taxation, and other more controversial subjects. At the same time, efforts at the EC level to achieve common policies on immigration and migration, asylum and refugees, health measures (such as plans to deal with AIDS), and other critical issues have intensified. These new efforts, unlike prior attempts at intergovernmental policy-making, occur under the aegis of and with full participation by the EC Commission.[25] In addition, the large numbers of tourist visiting the EC each year must be taken into account, particularly as their circulation through the EC relates to visas and taxation.

In the process of reviewing proposals in these areas, the Council can draw upon the Benelux experience. The Benelux Union Treaty, cited above, contains provisions transferring all controls on the movement of people to the external frontiers of the union and, under its article 2, gives nationals of the three states an unlimited right to free movement therein and a similar short-term right to foreigners with sufficient means of support. Thus, the three countries by consultation establish a uniform external policy regarding third-country citizens, within the framework of their obligations under the EEC Treaty. This agreement on policy issues has been of crucial importance in the elimination of internal controls.[26] Further, special arrangements on visas, extradition, and other matters are permitted to exist between Benelux countries and third states, such as the so-called Schengen Agreement with their neighbors France and Germany. Provisions of that convention refer to the necessity of transferring needed controls to external frontiers.

Geography imposes other problems for the member states, such as the physical separation of Greece from the other countries. Denmark is a party to the Nordic Union, under which internal border checks have been eliminated among the Scandinavian parties thereto.[27] For purposes of that Union, Denmark's coastal boundary is an internal boundary at which no customs checks are to occur for nationals of the contracting parties. However, for the EC, that coast is an external frontier where all of the necessary customs and related checks are to occur. Devising common procedures is therefor difficult without agreement on underlying policies. The economic differences among the member states, particularly the uneven distribution of EC manufacturing operations, pose additional constraints on completely free movement.[28]

Efforts toward common qualification

Efforts to achieve completely the right of establishment guaranteed in the EEC Treaty have been extensive; the number of cases before both the European Court of Justice and member-state courts would seem to indicate the work has not been completed. For many years the emphasis has been on the harmonization of national standards for the conduct of service activities or the practice of the professions, after sets of minimum standards for the pertinent area have been laid down at the EC level. For some professions, given different systems in effect in various members (particularly in the legal area) and the high degree of importance the countries place on regulating them (especially the health care professions), it was difficult or impossible to agree even on the minimum standards, much less to achieve common training and control schemes. Despite the fact that it has become easier for individuals to provide occasional services across borders under supervision of local practitioners or on a limited basis, it has generally not been possible to work in all member states.

After seeing difficulties in achieving common standards and general harmonization for services such as hair dressing, architecture, dog grooming, and engineering, and the growing number of actions at the Court of Justice (many by Lawyers trying to affiliate across frontiers), the EC Commission suggested a fundamental change of method. Instead of achieving common training programs and professional rules, the EC Commission returned to the principle of mutual recognition of qualifications, set forth in article 57 of the EEC Treaty, as the best means of reaching the ultimate goal. In this regard, general EC criteria for training, experience and professional responsibility are to be adopted. After some short period of work experience, persons trained under approved programs would be deemed qualified in each member state to work on the same terms and under the same titles as nationals in the situs

[24] See, for example, the Adonnino Report, EC Bulletin, supp. 7/85, and Information Memo on "A People's Europe," Commission communication to the EC Council, COM (84) 446 final.
[25] In 1975, the so-called "Trevi Group" was created to try to coordinate policies on terrorism, drug trafficking, and security, but the EC Commission was neither represented nor involved. See Van der Woude, Marc and Philip Mead, "Free Movement of the Tourist in Community Law," 25 CMLR (Spring 1988) p. 127.
[26] Ibid., pp. 117, 126.
[27] Protocol of May 22, 1954, and Convention of July 12, 1957.
[28] Elling, The European Community: Its Structure and Development, CRS Report, p. CRS-33.

country, subject to the ethical standards of the latter.

Anticipated Changes

Pursuant to the program laid out in the White Paper, several directives dealing with aspects of free movement of person have appeared. Some of these will be discussed briefly herein, and other EC instruments and activities will be discussed in other sections of this report. It may be observed that none of these measures would break entirely new ground, but instead would represent the completion of long-contemplated changes in the pertinent area.

The first such measure is a proposal, designated as (79) 215 and amended subsequently by COM (85) 292 final,[29] that would oblige the member states to terminate all restrictions on the right of entry and permanent residence for nationals of member states and their families and dependents (regardless of the nationality of the latter persons) along with any measures inhibiting the exit of any such persons desiring to relocate. The proposal guarantees the issuance of either an identity card stating the holder's nationality or a passport, the latter of at least 5 years' duration. Proof of nationality and of the ability to be self-sufficient (or of dependency for non-EC nationals who are family members or dependents) would be the only documents required to obtain such a permit. The directive would not grant such a right to persons going to another member state for vocational training. This measure would be effective 12 months after adoption by the Council.

The second measure creates a general system for the recognition of higher education diplomas acquired by member-state nationals in any member state.[30] This directive allows the countries to set minimum professional or training standards applicable to all EC citizens for any trade or profession not covered by minimum standards adopted at the EC level. The member states may require proof of work or professional experience to a maximum number of years specified by controlling directives, or of 3 to 4 years in the absence of such limits, and can continue their own schemes for professional responsibility and discipline on terms applicable identically to all member-state nationals.

A third document, Council decision 86/365 of July 24, 1986, *O.J.* No. L 222 (Aug. 8, 1986), p. 17, created a program for encouraging cooperative university-private enterprise efforts in technology training. Continuing prior efforts in this area,[31] the Council saw a need to advance still further the competitiveness of EC industries and the general technological base. The new program, labeled COMETT, is to assist in joint efforts across borders to improve the level and supply of training schemes and to provide funding for their establishment and operation. The Council also emphasized that both boys and girls are to be assured equal opportunity in technological and scientific fields. Periodic reporting by the recipients and by the EC Commission are to continue and, where needed, funding amounts or basic criteria reevaluated.

A subsequently proposed Council directive, amending many earlier directives on the mutual recognition of qualifications of health care professionals,[32] would specify for member states not previously covered the diplomas that would be recognized by all the other member states. The professions involved are midwife, veterinary surgeon, dental practitioner, doctor, and nurse responsible for general care. The measure would also identify particular medical specialties involving special training and titles that would likewise be recognized. Finally, persons who qualified under prior EC-recognized training programs would be "grandfathered" under this directive. Restrictions as to the dates of their training would be set.

These measures are not of importance for their direct effect on U.S. interests, which is minimal given that they apply to nationals of member states rather than more generally. However, two points should be kept in mind. First, to the extent that U.S. service or manufacturing operations wish to hire member-state nationals, these persons could move freely through the 12 countries performing their activities on the same terms as nationals of their host. This arrangement would provide greater flexibility to these firms, permit them to establish longer relationships with such persons, avoid repeated training in firm procedures, and reduce the number of people having knowledge of firm affairs.

[29] See *O.J.* No. C 207 (Aug. 17, 1979), p.14 and *O.J.* No. C. 171 (July 10, 1987), p. 8.

[30] Council Directive 89/48/EEC of Dec. 21, 1988, *O.J.* No. L 19 (Jan. 24, 1989), p.16, enacting Council directive COM(85) 355 final as amended by COM(86)257 final [*O.J.* No. C 217 (Aug. 28, 1985), p. 3 and *O.J.* No. C 143) (June 10, 1986.), p. 7, respectively]. The amended version is less sweeping than the original, limiting its scope to the recognition of diplomas awarded after training courses at least 3 years in duration and specifying that, rather than changing member-state programs, it is intended to allow migrants to practice their professions under special arrangements but under situs-country ethical standards. The directive would also allow newly qualified persons to come immediately to a different member state to complete the supervised practice period and the be deemed qualified to work freely.

[31] Decisions 85/141/EEC *O.J.* No. L 55 (Feb. 23, 1985), p. 1; 85/195/EEC *O.J.* No. L 83 (Mar. 25, 1985), p. 1; 85/196/EEC *O.J.* No. L 83 (Mar. 25, 1985), p. 8; 85/197/EEC *O.J.* No. L 83 (Mar. 25, 1985), p. 13, established various entities to "Stimulate European scientific and technical cooperation and interchange" (preamble to current decision).

[32] COM(87) 577 final of Dec. 2, 1987, *O.J.* No. C 353 (Dec. 30, 1987), p. 17.

Second, these measures would seem likely to help EC firms achieve greater efficiency and competitiveness, with regard to EC and third-country competitors alike. If freedom of residence, broader recognition of qualifications, and business-educational cooperation become reality, EC firms may be better positioned to challenge non-EC rivals.

Possible Effects

U.S. exports to the EC

There is little potential for the directives covered here to have much impact on U.S. exports to the EC; any effect that the directives might have would be indirect. Decision 86/365, which promotes cooperation between universities and enterprises to achieve a common vocational training policy, was adopted for the purpose of fostering the EC's competitiveness with the rest of the world. The other directives reviewed here that relate to worker mobility or EC-wide educational and licensing requirements and standards were also adopted or proposed with a view toward increasing EC competitiveness. To the extent, then, that this overall goal is achieved, EC industry may increase its global competitiveness with other nations, including the United States. This improvement is especially likely with respect to the EC's plans for establishing and funding a common vocational training policy, because no similar programs are being planned for U.S. workers.

U.S. industry might also receive some indirect benefits from the proposals. Major subsidiaries of U.S.-owned manufacturers and service firms that are established in the EC and that employ EC workers would presumably benefit with the increased mobility and technical training of EC workers. Furthermore, the increased mobility of health care professionals that would result from (87) 577 and related directives could benefit the U.S. health care industry. In particular, the measures could help U.S.-held, investor-owned hospitals and hospital management companies, which own or operate hospitals in the EC. Taking into account the overall benefits expected to accrue to U.S. firms versus those to EC industries, the overall effects of these directives would be a slight advantage to EC firms.

Diversion of trade to the U.S. market

Because these directives concerning EC nationals would have negligible effects with respect to U.S. interests, as well as those of its major trading partners Japan and Canada, little or no diversion of trade to the U.S. market is likely.

U.S. investment and operating conditions in the EC

Owners of some U.S. hospital management companies believe that directives such as (87) 577, which might result in greater mobility of health care professionals in the EC, could spur increased U.S. investment there because their companies would be better able to rationalize their operations in different EC countries. The remaining directives are not expected to have more than a negligible effect on the general levels of U.S. investment or business operating conditions either in the EC or in the United States.

U.S. industry response

Because U.S. professionals and other workers are trained and/or employed in the EC, and because U.S. companies with operations in Europe usually prefer to hire host-country nationals for positions there, there has been little response or interest from the U.S. industry regarding the directives covered here. U.S. industry officials contacted by USITC staff are less concerned about general efforts to increase the competence and mobility of EC labor than with other directives related to product standards and government procurement, because these measures have a more direct effect on their sales of products and services in the EC market.

Views of interested parties

Members of the health care industry contacted by the USITC have indicated their interest in the directive on mutual recognition of diplomas and the previous directives to which it relates, because of the flexibility it adds with regard to staffing. As noted above, few U.S. industries would be affected by these measures.

Protection of Workers

Background

Historical framework

Given the EEC Treaty's guarantee of freedom of movement for workers, and the efforts to attain approximation of the differing laws of the member states in many substantive areas, a move is now under way to vest in the EC some degree of authority for worker safety and health. Despite past studies done by or for the EC Commission, Council directives and decisions on some aspects of this subject, and input from the Economic and Social Committee, from working groups, and from representative organizations, this has not been an area where significant changes in member-state legislation have been made.

However, the EC has worked toward better conditions in places of employment. Under article 118 of the EEC treaty, the EC Commission was directed to promote cooperation and the exchange of information among the member states on improving conditions and places of work. The more formal EC program dates back to 1974, with the Council given power to adopt directives aimed at reaching safety and health

guarantees.[33] This responsibility was emphasized by new article 118A of the EEC Treaty (as added by the Single European Act), which required the Council to adopt appropriate measures by qualified majority to set minimum standards and to achieve harmonization of workplace safety and health laws. The member states are still permitted to adopt more stringent protective standards. However, variations in types of businesses and in general economic conditions exist in the member states, coupled with different attitudes as to government responsibility for creating and funding such controls (so that in one member state detailed laws or regulations may provide protections that in another must be attained through collective bargaining in each firm).

Scope of the new measures

These EC efforts may have an impact on U.S. operations within the EC, because the directives would cover manufacturing facilities, stores, offices, government buildings (except foreign embassies but including other posts of third countries), and all other places of work. More specifically, "workplace" is defined for purposes of these proposals as anywhere in an undertaking or establishment where there is worker access, and "undertaking and/or establishment" is defined as "a public-sector or private-sector body engaging in particular in industrial, agricultural, service, educational or cultural activities." Thus, schools, theaters, farms, and other sites not always covered by worker protection laws at the national level would be brought under the EC proposals. Embassies would apparently be completely exempt under the international law/treaty concept that such installations are actually part of the sovereign territory of the countries concerned, rather than part of the situs country, for political and legal purposes.

These directives have common underlying principles, especially worker notification of and training as to potential hazards. It is possible that, given member states' existing legislation and self-imposed standards, U.S. firms operating in the EC might face little or no added expenses or changes, at least at present. However, that situation may change over time if the EC institutions assume a greater role in worker-safety issues. Also, U.S. firms may modify their operations either in the EC or in this country if a substance is banned in one but not in the other, potentially influencing production methods.

Anticipated Changes

Four proposed Council directives are significant because they apply to a broad range of places of employment. Other measures, such as proposals to regulate work at visual display units and labor involving risks of back injury,[34] are also under review. The terms of the draft measures would permit future expansion of coverage and require regular reporting on compliance efforts made. At this point, however, it does not appear that the EC intends to supersede national authority to deal with these issues or to supplant existing measures in compliance with the EC's directives.

One proposed directive, designated as COM(88) 802 final of December 5, 1988, lays out the EC's concerns regarding worker protection efforts and would set general legal obligations and responsibilities for employers. Employers would be required to try to minimize risks, provide safe equipment and thorough worker training about both its use and avoidance of related problems, and adapt machines and work to the capabilities of their workers to the extent reasonably practicable. Worker-employer cooperation and communication would be expected, and sufficient information would need to be given to workers to permit them to evaluate fully the risks at hand. Workers would likewise be assigned corresponding responsibilities. The measure is intended to be effective as of January 1, 1991.

The second such proposal cited as COM(88) 74 final of March 11, 1988[36] is intended to provide widely applicable standards to all places of work other than temporary or mobile worksites and means of transport. This instrument would place initial responsibility on the member states to ensure passage of appropriate legislation and to conduct adequate inspections. The measure would apply not only to new workplaces but also to any existing ones used after the measure's effective date (Jan. 1, 1991). All such national efforts are to be reported to the EC Commission, which will circulate draft and final measures to the other member states. Under the directive, all worksites are to be kept clean and safe, with equipment and machines in good repair and emergency exits well marked and cleared.

A third measure, COM(88) 76 final of March 11, 1989,[37] covers personal protective equipment and standards related to its use. This measure is intended to avert exposure to otherwise unavoidable perils—those that organizational efforts and safety procedures cannot alone prevent (such as work involving inherently dangerous materials). Employers would be obligated to supply free of charge appropriate personal (for one worker only, with most pieces) protective equipment and to ensure its proper

[33] Council decision 74/325/EEC, *O.J.* No. L 185 (July 9, 1974).

[34] Froposed directives COM (89) 195 and COM (89) 213 final, *O.J.* No. C 130 (May 26, 1989), p. 5 and No. C 129 (May 25, 1989), p. 6, amending earlier proposals.

[35] *O.J.* No. C 30 (Feb. 6, 1989), p. 19.

[36] *O.J.* No. C 141 (May 30, 1988), p. 6.

[37] *O.J.* No. C 161 (June 20, 1988), p. 1.

use through training and supervision. The proposal is to go into effect on July 1, 1990, followed by reporting over a 10-year period.

Finally, Council directive 88/364/EEC of June 9, 1988[38] would permit the EC-wide banning of specified chemicals or work activities found to pose threats to workers and mandate that employers keep workers informed of potential hazards. This instrument goes beyond earlier Council efforts in this area that limited exposure and regulated use but did not prohibit dangerous substances or activities across the EC.[39] Substances posing serious safety or health risks, when adequate precautions cannot be taken and when bans would not lead to the substitution of equally or more dangerous substances, will be added by the Council to the annex to the directive, following reports and consultations from all interested parties. As adopted initially, the directive banned 4 substances and certain salts thereof, with certain limitations. The member states are to implement the directive by January 1, 1990. Regular reports, input from EC institutions (including the Parliament and new developments could result in additions to the annex list.

Possible Effects

U.S. exports to the EC

It is unlikely that these directives will be trade liberalizing or create training opportunities for non-EC suppliers. Directive 88/364 currently bans the use or production of certain cyclic chemicals (2-naphthylamine and its salts, 4-aminobiphenyl and its salts, benzidine and its salts, and 4-nitrodiphenyl) except in clearly specified activities. These chemicals are also highly regulated in the United States by the Occupational Safety and Health Administration (OSHA). There are very few U.S. producers of the banned cyclic chemicals. At one time, these chemicals were used as intermediates to produce dyes; however, due to their carcinogenic nature, use in the United States has been stopped. U.S. exports of these chemicals are practically nonexistent. These cyclic chemicals fall in basket categories with levels of aggregation that make available SITC export data meaningless.

The other three directives are aimed at achieving health and safety standards in places of work, form the earliest stages of design to the continuing upgrade of facilities with the latest technological developments. They may affect trade indirectly because increased costs of compliance for firms established in the EC may make U.S. exports slightly more competitive; in addition, the measures may have spillover effects in non-EC countries if firms with EC operations change production methods or management procedures outside the EC. However, some costs would also be borne by U.S. subsidiaries and entities established in the EC.

Diversion of trade to the U.S. market

There are essentially no imports of the affected cyclic chemicals into the United States due to their carcinogenic nature and highly regulated use. However, the United States does import some dyes that are produced using these cyclic chemicals as intermediates in the production process. No diverted exports of these chemicals or other products are expected to enter the U.S. market as a result of the workplace health and safety directives.

U.S. investment and operating conditions in the EC

Very few U.S. firms produce the cyclic chemicals banned in the directive 88/364, and the best available information reveals no direct investment in the EC by U.S. producers of these chemicals. Given the small and contracting level of U.S. production, the high level of regulation, and the carcinogenic nature of these cyclic chemicals, it is unlikely that, even without the ban, any U.S. producer of these chemicals would desire to invest in production facilities for these chemicals within the EC. The principal changes in U.S. business operations expected from these directives are that companies may need to upgrade their standards to comply and, as a result, are likely to invest more in workplace health and safety directives.

U.S. industry response

At this time the full potential effect of these directives is unknown. The industry is currently studying these directives and information may be available in the future. As a result of industry contacts, however, it is believed that major U.S. industries are likely to have a favorable response. The measures may create additional export opportunities for producers of safety equipment and personal protective devices.

Views of interested parties

U.S. industries have not submitted their views concerning these health and safety directives. Views are expected to be made public after the principal industries have done further research.

Possible Effects

U.S. Exports to the EC

The directives discussed above are those that seem more important to U.S. interest or that have been commented on in the literature or in

[38] *O.J.* No. L 179 (July 9, 1988), p. 44.
[39] See, for example, directive 80/1107 of Nov. 27, 1980, *O.J.* No. L 327 (Dec. 3, 1980), p. 8.

the private sector. For the most part, these directives will probably be trade neutral, especially those that govern free movement of people and workplace safety. The directives on free movement of goods may encourage some increased U.S. exports to the EC because they tend to reduce the administrative burden of doing business with and among the various EC countries, thereby reducing costs and delay, Other suppliers to the EC market, including the EC member states will, share in this cost-reducing benefit.

Diversion of Trade to the U.S. market

It is unlikely that these directives will discriminate among the suppliers to the EC. Therefore, no diversion of exports to the United States is probable.

U.S. Investment and Operating Conditions in the EC

U.S. investment in the EC will not be adversely affected by these directives. EC investment by U.S. interests will probably increase as firms perceive more freedom of decision in determining where to locate facilities. Some investment in existing facilities may actually be required, however, as facilities are upgraded to comply with workplace safety regulations.

U.S. business operating conditions should improve because administrative costs of border crossing will be reduced and because firms will be able to rationalize more of their operations. U.S. industries with subsidiaries already operating in the EC will receive the same benefits as other firms in the EC, and thus they may receive an advantage in the EC market over U.S. businesses located entirely it the United States.

CHAPTER 8
TRANSPORT

CONTENTS

Chapter 8

Transport

Introduction

Transport is regarded as a public service in the EC and is largely controlled by local or central governments. Government control is exercised through fare-setting mechanisms, the number of routes served, and the quality of services provided. Control is also exercised through the industry's dependence on government subsidies since fares normally account for 50 percent or less of the revenues required to cover transport service costs. Fares are often set in one sector, such as in the road transport sector, to protect the operations of another sector, such as the railroad sector. This cross-subsidy policy often leads to inefficiencies in both sectors, thus increasing the costs to firms that depend on these transport sectors to bring their products to market. Air transport landing rights and cabotage (trade between two points within a country) are regulated through bilateral agreements between the United States and the individual member states in the EC. U.S. revenues received from all international transport services amounted to $22.4 billion in 1987. Data on the share of these revenues earned in the EC are not available. U.S. investments in the EC in all service industries, excluding banking, finance, and insurance, were valued at $3.0 billion in 1987.

Background

Transport is likely to become a key factor in the integration of the EC. Transport receipts currently account for more than 7 percent of the EC gross domestic product. Without the orderly movement of goods and services across boundaries of the member states, efficiencies expected from integration through larger plants and economies of scale in the manufacturing sector may not be fully realized. Long delays at the borders of the member states may put at risk the adoption of computer-controlled manufacturing, just-in-time inventory, and manufacturing schedules. Thirty years after the Treaty of Rome, the EC still maintains a patchwork of transport quotas, restrictions, and limits on access to the transport market. As a result, long delays at border crossings, amounting to 40 percent of trucks' delivery schedules,[1] and duplication of transit documents are commonplace in the EC. It is estimated that a 750-mile trip by transport truck in the EC requires a total of 63 hours to complete.[2] Many of these delays reportedly are related to the value-added tax adjustments required at the borders of the member states. Exporting from one member state to another requires a time-consuming procedure of paying valued-added taxes and receiving credit for previously paid value-added taxes. This procedure is repeated at each border crossing.

In order to ease the problems associated with the inefficient movement of goods and passengers, the EC has adopted a series of measures that at first will liberalize transport between member states and later will open up the markets of member states to nonresident EC carriers. At this time, however, no agreement on the harmonization of value-added taxes by the member states in the EC has been reached.

Air Transport Sector

Anticipated Changes

Directives proposed in the EC for deregulating the air transport sector were largely shaped in April 1986 by the Court of Justice decision in the *Nouvelles Frontieres Case*, which held that rules of competition under the Treaty of Rome were applicable to air transport.[3] Following that decision and in December 1987, the EC Council applied the Treaty of Rome's competition rules to pricing, access to routes, and capacity sharing. Under these competitive rules, airline passenger fares will receive automatic government approval provided prices are set within agreed upon limits.[4] Carriers that can show that their fully allocated costs justify a fare below these limits can force arbitration on member-state governments that refuse to grant these low fares. Air cargo rates are not included in these price-setting rates because the EC Council reportedly believes that cargo fares are competitive as they now stand.

Under Council direction, access to routes will be liberalized, allowing multiple carriers to serve a market in the first year of the agreement, when the number of passengers reaches 250,000 per year. In the second year, this threshold will decrease to 200,000, or 1,500 flights; in the third year, to 180,000 passengers, or 1,000 flights. The access provision also provides for the right to serve more than one point on the same route, such as Rome to London to Frankfurt. Capacity sharing between national carriers of the member states was formerly on a 50–50 basis, but under the deregulation provisions, capacity sharing can range from a 45–55 basis in the first year of the agreement to a 40–60 basis in the second year. Under these provisions, an airline can increase its

[1] *Journal of Commerce*, Mar. 2, 1989, p.1.
[2] *Industry Week*, Feb. 6, 1989, p. 54.
[3] The 1992 Club, *Computer World* (December 1988–January 1989), p.16.
[4] The Court of Justice strengthened the concept of directive 87/601, in the Ahmed Saeed Flugreisen and Silver Line Reeseburo decision adopted Dec. 14, 1987. The Court held that bilateral or multilateral fixing of air fares for flights between member states was void under art. 85(2) of the Treaty of Rome, if they had not been exempted by the EC Commission under art. 85(3).

capacity in the first year by up to 10 percent if it already has 45 percent of the capacity. In addition to the Council agreement, the EC has promised to issue regulations covering computer reservation systems, user charges, requirements for pilots, and other subjects.

Possible Effects

(Directives 87/601, 87/602/87, O.J. No. C78/7–11, COM(88) 126 [final], and Regulation 3975/87)

U.S. exports to the EC

These directives are not expected to result in an increase or decrease in U.S. exports to the EC, but would be likely to have a neutral effect on U.S. interests. However, should the liberalization of regulations concerning air fares between member states, passenger capacity rates, and access to scheduled air service routes between member states prove successful, similar agreements may be pursued with non-EC members. If similar agreements are pursued, the U.S. transport industry could benefit from increased competition on transatlantic routes. The reduction of fares by EC airlines would probably stimulate demand, thus increasing the number of U.S. flights permitted under bilateral capacity-sharing agreements. The integration of the European air traffic market could also lead to a single negotiating unit, becoming stronger and more effective than is the case with individual countries when improved cabotage rights are sought.

Diversion of trade to the U.S. market

It is not likely that the subject directives would encourage diversion of trade to the U.S. market because cabotage and landing rights for air service are negotiated between countries throughout the world on a bilateral basis. If a non-EC air carrier is adversely affected in the EC by these proposed directives, it is unlikely that the carrier could redirect its capacity to the United States without prior discussion and agreement with the U.S. Government.

U.S. investment and operating conditions in the EC

These directives would neither favorably nor adversely affect existing and future U.S. investment and operations in the EC. Potentially, however, they could lead to opportunities and/or disadvantages for the U.S. air carriers. If the EC permits foreign capital investment in its air-traffic capacity, ground-handling abilities, or associated services, the U.S. air-transport industry may benefit from these directives, provided the industry chooses to invest in what is now a closed market. The benefits to the U.S.-air carriers would come from the increased deregulation permitted in the EC-transport market, if U.S. investment in the EC is permitted. U.S. air-passenger services to the EC are important to the U.S.-transport industry, and EC deregulation could provide increased market opportunities for U.S. carriers since air fares in the EC are higher than those in the United States. In addition, a more competitive atmosphere in the air-transport industry could beneficially affect U.S. ground-handling services at EC airports, allowing more freedom of selection by air carriers. Conversely, should the EC organize its air-transport industry as a single air-traffic system, it could increase its bargaining powers with the United States and other countries over existing international air-traffic agreements.

U.S. Industry Response

The U.S. air-transport industry will not be immediately or specifically affected by these directives; however, the industry may be affected by the secondary effects outlined above. U.S. airframe manufacturers, aircraft engine manufacturers, and trade associations have indicated that no specific actions be taken at this time with respect to these proposed directives. Rather, industry officials indicate that they are adopting a cautious attitude with regard to the directives, noting that governments have been known in the past to take actions contrary to existing laws/directives.

Views of Interested Parties

No formal submissions were received.

Road Passenger Transport Sector

Anticipated Changes

Directives proposed to improve services among member states in the passenger transport sector streamline procedures under which nonresident EC service providers can operate, thus facilitating border crossings and eliminating the requirement that passenger-transport companies maintain separate offices in each of the member states they serve. These directives attempt to unify and simplify the rules and regulations governing passenger bus services and ease the procedures that EC firms must meet in order to enter the passenger transport market among the member states. The directives prohibit member states from discriminating against other EC passenger-transport service providers on the basis of their nationality or country of establishment.

Possible Effects

Conditions for Nonresident Carrier Road-Passenger Transport Services/Rules for the International Carriage of Passengers by Coach and Bus (Directives: COM(87) 31, COM(87) 79)[5]

U.S. exports to the EC

These directives are not likely to create new opportunities for U.S. transport providers because the directives do not alter existing regulations regarding third-country suppliers. However, the directives do apply to nonresident EC carriers that are already established in another EC member state and could provide internal EC trade liberalization. U.S. passenger-transportation service providers are not active in the EC domestic market according to an official at the American Public Transport Association (APTA).

Because U.S. firms are heavily involved in travel and global-tourism industry, any limitations on the ability to establish or operate charter buses, tour buses, or regular intercity bus service in the EC could adversely affect U.S. firms after 1992. As mentioned above, however, there is currently no U.S. investment in regularly scheduled bus service within the EC.

Diversion of trade to the U.S. market

There are no major third-country suppliers in the EC passenger-transport industry at this time; current regulations effectively limit third-country participation, and bus service trade is not readily redirected to other regions. Therefore, there are no non-EC providers of passenger road services in the EC that are likely to enter the U.S. market solely as a result of the passage of these directives.

U.S. investment and operating conditions in the EC

U.S. investment in the EC is not likely to increase or decrease as a result of these directives, nor will the directives have an effect on business operating conditions for the U.S. bus industry in passenger-transport services in the EC. Conditions for all firms operating within the EC may be improved as a result of streamlined transportation and a possible reduction in transport costs as a result of a reduction in paperwork and other procedures. Industry sources indicate that certain passenger-transport firms are considering whether to establish European subsidiaries, but currently none have done so.

[5] COM (87) 31 has not been adopted and was amended by COM (88) 596.

U.S. Industry Response

Major U.S. transport firms are not expected to take any action in response to these particular directives. Should U.S. passenger-transport firms receive permission at a later date to enter the EC market, these internal regulations would then become important. APTA is planning to schedule a conference on these trade issues in 1989, at which members are expected to discuss the potential for opening trade talks with the EC. APTA is reportedly concerned that the EC may foreclose APTA members from the EC market.

Views of Interested Parties

No formal submissions were received.

Road Freight Transport Sector

Anticipated Changes

Directives proposed to improve services in the road transport sector expand the freedom of nonresident EC carriers to provide trucking services throughout the EC. The form of market organization currently in place is a system of bilateral quotas under which member states allocate a limited number of journey authorizations among themselves and in turn issue them to trucking companies. The authorizations are usually limited in that they entitle the holder to transport goods for only that bilateral link. According to EC opinion, this system is costly and restrictive, and does not protect the railroad transport system as it was originally intended. As a result, the bilateral quota system will be phased out and replaced by an EC authorization system. Because the organization of the EC market for the carriage of goods by road is undergoing significant change, the EC has elected to extend the current rate-setting regulations rather than introduce new arrangements regarding the setting of rates.

Possible Effects

Fixes the Rates/Nonresident Carrier Operating Rights/Access to the Market/Amends Transit Regulations (Directives: COM (87)584, COM (85)611, COM (87)729; amends (83)340 and (86)595, and Council Regulation 1674/87)[6]

U.S. exports to the EC

These directives are not likely to create new opportunities for non-EC suppliers, because the directives do not alter existing rates or regulations as they relate to third-country suppliers. However, the directives do apply to nonresident EC carriers and would provide internal EC trade liberalization. The U.S. trucking industry (as

[6] COM (85) 611 was proposed in 1985 and has not been adopted. Com (87) 729 has been superseded by regulation 1841/88 which was adopted on July 1, 1988.

potential exporters of this service) probably would not be affected by most of the directives.[7] The directives can be expected to provide some benefit to U.S. firms shipping goods within the EC by lowering internal transportation costs and reducing paperwork and procedures. Since the directives facilitate transport among EC member states by easing the regulations with which operators must comply, it is anticipated that the directives will increase competition and business within the EC transport market.

The directives will not change the effect of existing barriers to entry into EC markets. Most EC countries currently have regulations that effectively restrict non-EC providers of road-haulage services. New proposals merely open individual EC member states' markets to other EC members. Current U.S. participation in EC markets is extremely limited.

The new regulations, according to an industry source, also fail to take into account the degree of control that brokers exert in the EC transport market. Officials maintain that several EC Members—West Germany in particular—have their freight and transport markets controlled by a select group of brokers who, in effect, set routes, rates, and schedules. These brokers are reportedly resistant to change and do not welcome new entrants into the European transport market.

Diversion of trade to the U.S. market

There are no non-EC providers of trucking services in the EC that are likely to enter the U.S. market as a result of the passage of these directives. It is unlikely that a major third-country supplier could be injured to the extent that the services it provides would be diverted to the U.S. market, as there are no major third-country suppliers in the EC trucking industry at this time; current bilateral agreements effectively limit third-country participation.

With respect to specialized package-delivery service, the market has grown significantly in recent years. The largest firms serving this market are those from the United States, Australia, and West Germany. Because the United States is one of the largest markets for these services, any firm wishing to enter the global package-delivery market would be likely to establish facilities in the United States.

U.S. investment and operating conditions in the EC

U.S. investment in the EC is not likely to decrease as a result of a continuance of an existing EC road haulage rate-setting regulation, or as a result of deregulation in the EC road haulage industry. Direct effects are not likely to include any decrease in U.S. trucking investment in the EC, nor will the directives have an impact on business operating conditions for the U.S. trucking industry. These directives are unlikely to have an effect on current U.S. trucking-industry investment in the EC because they neither open major markets to U.S. companies nor close those that are already open. Lower transportation costs could attract U.S. firms to establish EC subsidiaries as EC regulations permit. However, large transport trucks operating in the United States may not be permitted to operate in the EC because the European road and bridge systems and European tunnels are not designed to handle these vehicles.[8] Indirectly, operating conditions for all firms operating within the EC may be improved as a result of streamlined transportation services and an anticipated reduction in paperwork and procedures associated with transport costs. The West German Federal Association of Shippers (truckers assocciation) contends that the deregulation of the road-transport industries will create excess capacity in the EC and lead to increased concentration as deregulation did in the United States.[9]

At present, the level of U.S. investment in the EC transport market is small.[10] Some U.S. air-freight firms providing package-delivery service and cargo service have established facilities in the EC to offer door-to-door deliveries to U.S. and European clients. Directives improving the efficiency of the European transport market should increase the return on U.S. transport-facility investments within the EC and encourage investment in the EC by high-volume U.S. transport firms. However, if non-EC-based service providers are left at a competitive disadvantage by the regulations adopted in the EC transit market, then U.S. firms will not share in the EC transit market growth.

U.S. Industry Response

Major U.S. firms in the industry are not expected to take any action in response to these directives. If U.S. trucking firms are permitted to enter the EC market at a later date, then internal regulations would be of importance to them. A major U.S. package express carrier association welcomes the directives, as its members feel that lower barriers to trade among EC nations will lead

[7] A requirement in COM (85) 611 may exclude foreign-owned firms if the majority European-ownership (genuine link) requirement is not deleted. There are indications that the requirement will be deleted because the intent was to prevent dumping of road services by East Europeans.

[8] USITC staff meeting with a member of the United Kingdom Department of Transport, International Transport Division, May 8, 1989.

[9] USITC staff meeting with a member of the Bundesverband des Deutschen Guterkraftverkehrson, May 23, 1989.

[10] Significant foreign investment exists in the U.S. motor-carrier industry, particularly in the tank-truck segment. The only U.S. motor carriers with significant holdings in Europe are household-goods movers.

to improved air freight between EC and U.S. companies, thus benefitting U.S. package-delivery companies. However, the association does not anticipate any direct benefit for U.S. truckers and road-hauling services from these directives, except that for the increased business experienced as a result of increased trade between the United States and the EC.[11]

Views of Interested Parties

No formal submissions were received.

Maritime Transport Sector

Anticipated Changes

Directives proposed to integrate services in the maritime transport sector are intended to ensure that member-state nationals are free to provide sea-transport services among and within member states. All existing national restrictions that reserve the carriage of goods to vessels flying the national flag will be phased out along with existing bilateral cargo-sharing agreements with third countries. EC competition laws will be applied under these directives much like those administered in the United States by the Federal Maritime Commission. U.S. laws regulate international shipping conferences, which are exempt from U.S. antitrust and price-fixing regulations. Unlike the United States, the EC has not collectively regulated conferences in the past, but under these directives, liner conference agreements that can fix rates, coordinate sailings, and allocate cargo will be exempt from EC competition rules, subject to certain conditions. Directives also address the issue of harmonizing EC cabotage rules in order to facilitate transportation within member states. A proposal has been approved in principle, but problems have arisen over cabotage laws affecting inland waterway transportation because most EC member states require that domestic inland waterway transport be provided by resident carriers. The proposal would allow carriers registered in one member state to transport goods and passengers by inland waterways of another member state, as is currently provided for on the Rhine River under the Rhine River Agreement. The carrier in the host country must be registered under its rules and regulations and must be majority owned and controlled by nationals of member states.

[11] The American Trucking Association, which represents general freight trucking companies, tank-truck haulers, and household-goods movers, is encouraged by initiatives that facilitate cross-border highway transport. However, the association believes that potential benefits could be lost with a move to restrict foreign ownership.

Possible Effects

Freedom to Provide Services/Unfair Pricing Practices/Application of Articles 85 and 86/Free Access to Cargoes/Non-resident Carriers on Inland Waterways

(Numbers of Directives: COM 4055/86, 4056/86 [incorporates COM (85) 90], 4057/86, COM 4058/86, COM (85) 610)[12]

U.S. exports to the EC

Proposal 4055/86 is not likely to be trade liberalizing, nor is it likely to create trading opportunities for non-EC suppliers. The regulation was proposed to ensure the right of citizens of one member state to provide maritime transport services among other member states. These proposed directives do not directly address the rights of non-EC suppliers currently providing services in this market. The directives indicate what is permitted by member states, but do not indicate what is permitted by nonmember states. Non-EC maritime companies are expected to strongly oppose any attempt to reserve all routes within the EC for only EC companies, and U.S. exporters are not likely to enjoy any special benefits. Future opportunities in the EC for the U.S. maritime industry may be affected if the interpretation of the rules leads to additional barriers to trade, even though the current wording of this directive does not directly address the issue of non-EC carriers.

Proposal 4056/86, which applies EC competition law to maritime transport between ports of member states, is not likely to be trade liberalizing, as the directive provides for monitoring of international shipping conferences to ensure compliance with EC law. Non-EC countries and EC member states often belong to the same shipping conference, and thus would be subject to the same additional regulations. At the present time, however, there is little non-EC participation in EC port-to-port trade. It is unclear whether this directive would make it more difficult for non-EC countries to provide shipping services in this arena; it will depend on the interpretation of the regulation as to how EC competition rules would apply to shipping conferences. If the EC interpretation were to differ significantly from current practices, then third-country suppliers of the service may find it more difficult to enter the market. Future opportunities in the EC port-to-port trade for the U.S. maritime industry may be affected if the interpretation of the rules leads to additional barriers to entry; however, U.S. maritime interests are not currently involved in the market to a significant degree.

[12] COM (85) 90 was proposed in 1985 and was partially adopted in 1986. Com (85) 610 was also proposed in 1985, but has not been adopted. Cabotage rulemaking has not been adopted as of May 1989.

Proposal 4057/86, which permits the EC to apply duties in order to protect the shipowners of the member states from unfair pricing practices by third-country shipowners, is not likely to be trade liberalizing, as the directive provides for monitoring of international shipping to ensure compliance with EC law. Disputes are settled by competent authorities in the member states and by the EC Commission. Non-EC suppliers and EC member states often belong to the same shipping conference, and thus would be subject to the same additional regulation. Depending on the interpretation of conference activities by the EC, the regulation may have a negative impact on the participation of shipping conferences in the trade. It is possible that certain aspects of proposal 4057/86 would make it more difficult for non-EC countries to provide shipping services in this arena. If the EC interpretation were to differ significantly from current practices, then third-country suppliers of the service may find it difficult to serve the market. It is unlikely that U.S. interests will be significantly affected relative to those of other third-country suppliers. The EC directive addresses all non-EC carriers equally. The United States does have a significant portion of the conference fleet serving the Atlantic trade; however, the U.S. share could only be affected under this directive in the case of an EC determination of unfair pricing practices.

Proposal 4058/86 would safeguard free access to cargoes for member states. It was thought necessary because of a perceived tendency of third countries toward price-fixing regulations and cargo-sharing arrangements. The proposal is intended to limit the reservation of cargo, particularly with respect to bulk trades which operate in a competitive environment. This proposal is unlikely to have a negative impact on that environment.

Proposal (85) 610 is not likely to create new trading opportunities for non-EC suppliers, as this proposal focuses on internal liberalization of inland waterway transport. The proposal was prompted by a desire to liberalize and harmonize cabotage rules in order to facilitate transport among the member states. The proposal will not provide any direct benefits to U.S. maritime companies, which are not active in EC inland waterways trade; rather, it can be expected to provide some benefit in the form of reduced transportation costs to any firm shipping goods within the EC. The directive will not change the effect of existing barriers to entry in EC-related cabotage regulations. Cabotage regulations currently prohibit non-EC providers of inland waterway transport. Since inland waterway transport is already closed to non-EC participation, this directive will have no particular effect on the U.S. industry.

Diversion of trade to the U.S. market

It is unlikely that a major third-country supplier will be injured to the extent that its service would be diverted to the U.S. market; foreign flag carriers are barred from entry in U.S. trade under the cabotage provision of the Jones Act. However, if third-country carriers providing services between EC ports are barred from continuing to provide that trade, it is possible that the carriers would concentrate more on transatlantic or transpacific trade and thus provide more competition for U.S. carriers in those arenas.

There are no major third-country suppliers in the EC inland waterway transport industry at this time; current cabotage law prohibits non-EC suppliers from providing inland waterway transport.

U.S. investment and operating conditions in the EC

It is unlikely that the directives will adversely affect current U.S. investment, as the provision of shipping services does not necessarily require large fixed investments in the area for which the service is provided. In addition, U.S. maritime interests are not specifically addressed in the current wording of these directives. There is no significant U.S. investment in EC inland waterway transportation at this time. Collectively, the directives are not likely to have a significant effect on future U.S. investment in the EC, since they do not specifically affect current U.S. industry concerns. Operating conditions are also likely to remain unaffected, as the directives do not address the issue of third-country rights.

Proposal 4057/86, if interpreted restrictively, may have an unknown level of impact. U.S. maritime interests are unlikely to expand in the trade if services are restricted or subject to new additional regulation.

U.S. Industry Response

If directives are interpreted in a restrictive manner, U.S. maritime interests may express their concerns.

Views of Interested Parties

No formal submissions were received.

Possible Effects on All Transport Sectors

U.S. Exports to the EC

The EC transport directives would apply only to member states and are silent with respect to bilateral agreements in effect between the EC and third-party countries, such as those bilateral agreements with the United States. It is anticipated that existing U.S. maritime and air-transport bilateral agreements with the member states will remain largely unaffected until after EC integration in 1992. There has been a

great deal of speculation that after that time the EC may as a single entity elect to negotiate with third countries over the issue of cabotage, the right to carry local passengers and merchandise. Currently, U.S. vessels and aircraft can transport passengers and merchandise under existing bilateral agreements freely from one EC member state to another without violating existing cabotage regulations. Although EC member states have not announced that these bilateral agreements with the United States will be cancelled, many Europeans believe that if U.S. aircraft can fly between the various cities in Western Europe, or U.S. vessels can offer services between European ports, it is only equitable that national airlines of member states are allowed to fly between various U.S. cities and vessels are permitted to make similar ports of call. Cabotage has been prohibited in the United States since the beginning of air travel, and almost all other countries have adopted laws and regulations prohibiting cabotage.

According to an industry source, the major problems that U.S. airlines have had in member states relate to airport access, computer reservation systems, user fees, and ground-handling services. Foreign carriers in the United States have been given the privilege to freely provide ground-handling services for their respective national airlines, but U.S. carriers have reportedly had difficulties in obtaining reciprocal rights within the member states. Ground-handling services, which can include aircraft maintenance, passenger ticketing, catering, and cargo loading and delivery were not covered by the EC Aviation Agreement. The U.S. Department of State and the U.S. Department of Transportation have been active in seeking relief in these areas, but since the EC directives are silent on the issue of these services, one can only speculate as to how existing services will be integrated after 1992.

Computer reservation systems operated by airlines in the United States are required to be nondiscriminatory by the U.S. Department of Transportation. Competing systems must be made available to all carriers on an equal basis, but because of a lag in technology, European systems have evolved more slowly, thus permitting individual carriers to erect procedures that tend to discriminate. An industry source has indicated that the EC is likely to place into operation over the next 2 years two major systems, which will be owned by a group of carriers. It is not clear whether other systems will be permitted to compete with these systems or whether the two systems will be permitted to compete with each other. It is also not clear how foreign carriers will be treated and whether they will have the nondiscriminatory and transparency features found in the U.S. systems.

With respect to user fees, the use of U.S. airspace for all airline carriers is provided by the U.S. Government without charge. In contrast, U.S. carriers, according to an industry source, are charged more than $60 million annually for the use of European airspace. According to a U.S. air-transport official, the charge for the use of this airspace should be based on reasonable costs that are made available to carriers for verification.

One of the major problems that could develop over EC integration is the prevention of the establishment of foreign service providers, particularly integrated, multimodal companies such as those providing both air and road transport of passengers and goods. U.S. firms such as Federal Express could be disadvantaged in competition with multimodal carriers in member states if barriers are erected that would prohibit such expanded services. Currently, most member states have regulations in place that effectively restrict non-EC service providers of road haulage services. New regulations merely open up the markets of individual member states to each other.

Total U.S. receipts for international transportation services amounted to $16.2 billion in 1983, increasing to $22.4 billion in 1987.[13] Receipts were about equally divided between those received from ocean-transport services and those received from air-transport services. Port services and export-freight services combined accounted for 93 percent of total U.S. ocean-transport services in 1987, and passenger fares and airport receipts accounted for 91 percent of air-transport receipts. U.S. payments to foreign providers of international transportation services exceeded receipts each year during 1983–87, increasing from $18.2 billion to $26.9 billion. Payments for ocean freight, principally those for import freight, amounted to $11.8 billion in 1987, and payments for air transport, principally passenger fares, amounted to $14.9 billion. The U.S. negative balance of trade in international transport services increased from a deficit of $2.0 billion to a deficit of $4.6 billion during the period. Much of the deficit in U.S. international transport services occurred in air-transport services. Data on U.S. international transportation services for 1988 are not available.

Data on international transportation services provided to EC member states are not available, but it is believed that U.S. air-transport passenger services provided to the EC were much larger in 1987 than that with countries in the Far East. Passenger and cargo traffic with countries in the Pacific region, however, is growing more rapidly, and reportedly, cargo traffic with the Far East already is larger than that with Western Europe.

[13] U.S. Bureau of the Census, *Statistical Abstract*, June 1988.

Economies of the Pacific Rim countries are currently growing 3 to 4 times faster than those of the countries in Western Europe, and that growth is expected to continue through 1992. Economic growth is likely to accelerate in the EC after 1992, however, as a result of the dismantling of internal barriers and elimination of fractionalized markets. The harmonization of value-added taxes among member states is likely to be required to ensure such growth.

Diversion of Trade to the U.S. Market

It is unlikely that the adoption of the transport directives will encourage a diversion of trade to the U.S. market because of bilateral agreements between the United States and member states in the EC. Landing and cabotage rights for air-transport services are negotiated on a bilateral basis throughout the world. Also, policies of member states effectively limit third-country passenger-transport services by road in the EC, and in addition, there are no third-country providers of trucking services in the EC. With respect to maritime and inland waterways services, if a carrier were barred from entry to the EC market, it is unlikely that ships of that carrier would be diverted to the United States because under the Jones Act and U.S. cabotage laws, foreign flag ships are not allowed to provide maritime services between ports in the United States. Non-EC providers are also not permitted to provide inland waterway transport services in the individual member states.

U.S. Investment and Operating Conditions in the EC

U.S. investment in all EC services industries, except banking, finance, and insurance amounted to $3.0 billion in 1987, accounting for 44 percent of U.S. investments in these services in all countries in 1987.[14] About 40 percent of these investments in EC services have been made in the United Kingdom, followed by about 31 percent in the Netherlands. Data are not available to determine the share of these investments that was made in maritime, road, and air-transport services. U.S. investments in the EC in banking, finance, and insurance amounted to an additional $22.0 billion in 1987.

U.S. investment in transport could increase significantly after 1992, depending on whether deregulation is extended to third-country service providers. More competitive freedom in the air-transport industry would probably bring additional U.S. investments in aircraft ground-handling facilities and computer reservation systems. Certain U.S. package-express carriers already are providing package-delivery service in the EC, and the industry association reports that lower barriers among member states will improve air freight operations between the United States and the EC and will encourage investment. The U.S. passenger-transport industry is global in scope, and if allowed to participate freely in the EC, would be likely to bring additional investment into the EC.

The cost of transport services in the EC is considerably higher than the cost of similar transport services in the United States, where the markets are deregulated. Costs per ton of cargo per kilometer in air-transport services in Europe are 50 percent higher than those in the United States.[15] More than 50 percent of road haulage trips in the EC are rationed by bilateral permits, and another 16 percent are permitted by EC-wide permits. These restrictive permit systems, which tend to drive up costs of transport services, are being undermined by manufacturers and retailers in the EC that are turning to specialized contract-for-hire transport firms to ship their products and away from transport firms carrying cargo for hire.[16] These contract-for-hire firms are not restricted in their rights to one-way road haulage to pick up or deliver cargo. With deregulation of transport in 1992, the EC is expecting that road-transport costs will decline by 5 percent, compared with a 10-percent decline in freight rates that were realized in the United States after deregulation in 1980. Railroads in the EC that have been protected by high air-cargo and road-transport haulage fees will be likely to feel increased competition from trucking firms that are now restricted by border controls and bilateral permits that are likely to be eliminated after integration and the harmonization of value-added taxes.

U.S. Industry Response

The U.S. transport industries are largely taking a cautious attitude toward the integration of the EC. The U.S. air-transport industry regards the directives with caution, noting that governments in the member states in the past have taken actions that have been contrary to existing laws and directives. U.S. firms producing merchandise in the EC look favorably upon these directives and support the goal that limits should not be placed on the movement of goods or the number of trucks a member state has on the road or the routes that trucks take. U.S. firms contend that for economic efficiency, freight costs relative to production costs should be as low as possible. U.S. transport service industries are also cautious that after integration the EC may attempt to cancel existing bilateral agreements with the United States and bargain as a unit over existing cabotage negotiations.

Views of Interested Parties

No formal submissions were received.

[14] U.S. Department of Commerce, *Survey of Current Business*, June 1988, p. 81.

[15] *The Economist* (July 9, 1988), p. 15.
[16] *The Economist* (July 9, 1988), p. 34.

CHAPTER 9
COMPETITION AND CORPORATE STRUCTURE

CONTENTS

CONTENTS—*Continued*

Chapter 9

Competition and Corporate Structure

Introduction

Mergers and acquisitions in the top 1,000 EC companies increased by 27 percent in 1986–87, in comparison with an increase of 17 percent in 1985–86.[1] Cross-border mergers, as a percentage of all mergers, also rose from 19 percent in 1983–84 to 20 percent in 1986–87. [2] With the increase in merger activity in the EC and the perception that a presence in Europe is the best strategy in planning for 1992, development of and control over merger policy by the Commission of the European Communities (EC Commission) has become of great interest to U.S., as well as EC, companies.

The first two directives examined in this chapter address the issue of competition policy. The controversial regulation on the control of concentrations (Merger Regulation),[3] if adopted by the Council, grants to the EC Commission the broad power to prohibit or allow mergers that fall within the scope of the Merger Regulation. The second directive discussed below focuses more directly on competition in the telecommunications equipment market, eliminating the monopolies held by the national postal, telegraph, and telecommunication authorities (PTTs) (Telecommunications Directive).[4]

The rest of the directives discussed in this chapter look at corporate structure. The third directive examined below creates a new corporate entity called a European Economic Interest Grouping (EEIG) (EEIG Regulation).[5] Lastly, this chapter looks at three directives that are part of the EC Commission's drive to harmonize the company laws of the various member states. The issues addressed by the various company law directives[6] are of interest to those firms with direct investments in different member states. These directives represent the most recent examples in a long process by which the EC Commission is striving to encourage and facilitate cross-border activity by, among other things, creating a new legal structure for cross-border cooperation and harmonizing the business laws that govern many day-to-day processes and activities of enterprises located in the EC. With the adoption and entry into force of all the company law directives, firms operating in more than one member state will no longer be required to comply with 12 different sets of rules but instead can apply the same standards throughout the EC, thus substantially simplifying their business.

Whereas the telecommunications-equipment directive affects only the telecommunications market, the other directives discussed herein all could have a potential impact on any enterprise that does business in the European Community.

Regulation COM(88) 734 Amended Proposal for a Council Regulation (EEC) on the Control of Concentrations Between Undertakings

The proposed regulation on merger control is not officially part of the program to complete the internal market in 1992.[7] The EC Commission has in fact tried for over 16 years to create a merger control regulation.[8] However, the expectation that in the years leading up to, and even after, 1992, major restructuring will occur in the European market has created an impetus for action on merger control. In addition, the decision of the EC Commission to broaden the reach of article 85 in the Philip Morris case[9] provided the Council with additional incentive to reexamine the possibility of a merger control regulation.[10] Although not included in the 1992 program, this proposed regulation is part of this study because it will have a direct impact on U.S. direct investment in the European Community.

Before it is finally passed, the merger control regulation will have gone through many drafts. This section will first describe the provisions of the draft dated November 30, 1988; but because another draft of the merger regulation is due to be published in late June 1989, a discussion of the major areas of controversy in the current draft will follow rather than a detailed analysis of the changes that may occur upon passage of a merger control regulation.

[1] Royal Institute of International Affairs, *Paper for the Anglo German study group: Making a reality of the single market* (Mar. 21, 1989), p. 2 [hereinafter "RIIA Paper"].
[2] Ibid.
[3] *Amended proposal for a Council Regulation (EEC) on the control of concentration between undertakings* COM(88) 734; *Official Journal of the European Communities (O.J.)* NO. C 22/23, [hereinafter "Merger Regulation"] (Jan. 28, 1989).
[4] *Commission Directive on competition in the markets in telecommunications terminal equipment, O.J.* NO. L 131/73 (May 27, 1988) [hereinafter "Telecommunications Directive"].
[5] *Council Regulation on the European Economic Interest Grouping, O.J.* No. L 199/1, (July 15, 1985) [hereinafter "EEIG Regulation"].
[6] See section on company law directives, p. 9-32 et seq., below.
[7] The White Paper in essence included a laundry list of those directives and regulations whose passage was necessary to complete the internal market. See *Completing the Internal Market*, White Paper from the EC Commission to the European Council, June 1985.
[8] See *Proposal for a Regulation (EEC) of the Council on the Control on Concentrations between Undertakings, O.J.* No. C 92/1 (Oct. 31, 1973) and *Amended proposal for a Council Regulation (EEC) on the control of conentrations between undertakings*, COM (88) 97; *O.J.* C130/05 (Apr. 25, 1988) (hereinafter "may draft").
[9] See note 17, below.
[10] USITC staff meeting with a member of the EC Commission, Legal Services, Apr. 17, 1989.

Background

In 1957, The Treaty of Rome[11] established the general principles prohibiting anticompetitive behavior in articles 85 and 86 of the treaty.[12] Article 85(1) prohibits any intra-member-state trade agreement that has the object or effect of restricting or distorting competition, and article 85(2) declares such arrangements void. Article 85(3), however, allows the EC Commission to grant an exemption from article 85(2) if the economic benefits from the activity outweigh any potential anticompetitive aspects. Article 86 prohibits abuse of a dominant position but contains no provisions for exemptions.[13] Council regulation 17[14] grants the EC Commission broad powers to implement articles 85 and 86. Nowhere in the Treaty of Rome is the creation or strengthening of a dominant position in the market prohibited.[15]

Control over mergers has been a longstanding problem in the European Community. Ignoring the merger control provisions in the Treaty of Paris, the drafters of the Treaty of Rome deliberately omitted rules on the formation of concentrations.[16] Without any specific grant of oversight authority over mergers, the EC Commission was forced to rely on its authority to protect competition under articles 85 and 86 in prohibiting mergers. In 1966, the EC Commission issued a memorandum in which it concluded that article 85 of the treaty was not applicable to agreements resulting in full or partial acquisition of one company by another.[17] The EC Commission was therefore forced to rely on article 86 of the treaty. In the first case to address the question of merger control, Europemballage Corp. v. Commission,[18] the EC Commission prohibited Continental Can from purchasing a controlling interest in a Dutch company that was a competitor of one of Continental Can's subsidiaries. The EC Commission reasoned, and the European Court of Justice (ECJ) confirmed, that because Continental Can already held a dominant position in the marketplace, the proposed acquisition of a competitor, resulting in the virtual elimination of any competition, was an abuse of a dominant position within the meaning of article 86. Although useful in come cases, article 86's shortcoming is that one company must hold a dominant position in the marketplace before article 86 can apply.

Recognizing the limitations of article 86, combined with the perceived inapplicability (at that time) of article 85 as authority to prohibit mergers, the EC Commission in 1973 drafted the first in a series of merger control regulations proposals.[19] Due mostly to the unwillingness of member states to relinquish control over mergers to the EC Commission, the merger control regulations failed to win approval.

In 1987, the EC Commission, in a complete reversal from its 1966 memorandum, decided that article 85 could be used to prevent the acquisition of a minority shareholding in a competitor, even when both remained independent.[20] In the Philip Morris case, the EC Commission objected to an arrangement between Philip Morris, Inc. (PM), a U.S. company in the cigarette business, and Rembrandt Group Ltd. (RG), a South African company, whereby RG would sell to PM one-half of RG's wholly owned subsidiary, Rothmans Tobacco Holding Ltd., which in turn controlled Rothmans International (RI), a cigarette company. In addition, RG and PM entered into a partnership agreement to cooperate in the management of RI. The oligopolistic structure of the European cigarette industry along with terms of the agreement providing for the direct involvement of PM in the affairs of RI, a direct competitor of PM, led the EC Commission to issue a statement of objection

[11] Treaty establishing the European Economic Community, Rome, Mar. 25, 1957; Treaty Series No. 1 (Cmd. 5170)[hereinafter "Treaty of Rome"].
[12] The provisions of arts. 85 and 86 do not apply in four areas: (1) coal and steel (addressed under the Coal and Steel Treaty); (2) transport (exempt under reg. 17, although a recent European Court of Justice decision appears to have brought intra-European air transport back under art. 85 See Firma Ahmed Saeed Flugreisen & Anor. v. Zentrale zur Bekampfung unlauteren Wettbewerbs eV [hereinafter "Ahmed Saeed"](Case 66/86)(unreported)(decided Apr. 11, 1989); (3) agriculture (art. 42 of the Treaty of Rome limits the application of antitrust to the Common Agricultural Policy); and (4) military goods (member states can take measures to protect their national security.)
[13] Kerse, C.J., *EEC Antitrust Procedures, 2d* ed., (London: European Law Centre, Ltd., 1987)
[14] *First Regulation Implementing article 85 and 86 of the Treaty, O.J.* No. L 204/62 (Feb. 21, 1962).
[15] It is not likely that failure to include control over mergers in the Treaty of Rome was an oversight because art. 66 of the earlier Treaty of Paris creating the European Coal and Steel Community (see above, ch. 1, "Institutional Mechanism for the 1992 Program") specifically gives the EC Commission exclusive control over mergers in the coal and steel industries. See address by Helmut Schroter, Antitrust Section of the American Bar Association Annual Meeting (April 5 to 7, 1989)[hereinafter, "Schroter Address"], p. 2. See also *Memorandum by the Bar Association for Commerce Finance and Industry*, House of Lords Select Committee on the European Communities, Session 1988 89, 6th Report, Merger Control, (H.L. 31)[hereinafter "Lords Report"], p. 38. Contrast sec. 2 of the Sherman Act, 15 U.S.C. sec. 2 (1988) (any monopolization, or attempt to monopolize, is illegal).
[16] Schroter Address, p. 1.
[17] *La probleme de la concentration dans le marche commun*, Etudes CEE, Serie Concurrence No. 3 (1966); see also Hawk, Barry, *United States, Common Market and International Antitrust: A Comparative Guide*, 2d ed. (Prentice Hall Law and Business, 1987)[hereinafter, "Hawk, *A Comparative Guide "]*, p. 653.
[18] *Common Market Reporter* (CCH) par. 8171 (1973)[hereinafter "Continental Can"].
[19] See note 6, above.
[20] Re agreements between Philip Morris, Inc. and Rembrandt Group, Inc., (decision of Mar. 22, 1984)[hereinafter "Philip Morris"]; *Fourteenth Report on Competition Policy* (1984), p. 81; [1984] 2 *Common Market Law Review* p. 40.

based on article 85(1). PM reduced its share in RI, returned control to RG, and abrogated the partnership agreement, whereupon the EC Commission approved the agreement.[21]

The Philip Morris decision concerned competition experts who viewed article 85 as an awkward tool for control of mergers. Whereas national courts can declare an agreement null and void under article 85(1), only the EC Commission is empowered to grant an exemption. Furthermore, it is questionable whether article 85 always applies when the takeover is attempted by means of a stock purchase because a stock purchase may not be an agreement.[22] Above all, the case-by-case technique is a haphazard approach, provides no legal certainty, and leaves large gaps in the EC Commission's authority. The concern generated by the ECJ's decision in Philip Morris is perhaps best reflected by the fact that, after more than 15 years of delay, within 2 weeks of the Philip Morris decision, the Council agreed to reconsider a merger-control regulation.[23]

The proposed Merger Regulation brings within the jurisdiction of the EC Commission mergers[24] that have a "Community dimension."[25] A merger has a Community dimension if the aggregate worldwide sales of the companies that are merging exceed 2,000 million ECU (approximately $2.2 billion),[26] and of least two of the companies each have EC-wide sales of at least 100 million ECU.[27] Regardless of the size, however, if the companies involved do more than two-thirds of their business within one and the same member state, their merger does not have a Community dimension.[28] The EC Commission must be notified of all mergers that fall within the scope of the Merger Regulation before they are put into effect.[29] A critical, and still controversial, aspect of the draft Merger Regulation is that if the merger has a Community dimension, the EC Commission acquires exclusive jurisdiction, which removes control over the merger from national jurisdiction.[30]

If the EC Commission finds that the merger is within the scope of the merger regulation, it then has four choices: it may find the merger compatible with the common market;[31] it may find the merger incompatible with the common market and prohibit it; it may find the merger incompatible with the common market but allow it nevertheless if it "bring[s] about general economic advantages which outweigh the damages to competition";[32] or it may allow the merger under certain conditions and obligations.[33] The general criterion that the EC Commission will apply in evaluating a merger is whether the result of the merger will impede effective competition.[34] The Merger Regulation sets out in article 2(1) the relevant factors that the EC Commission should take into consideration in evaluating the merger, and article 2(3) delineates the conditions under which the EC Commission may grant an exemption.

Anticipated Changes

Enactment of this proposed regulation is expected to result in substantial changes in European merger control, both procedurally and substantively. Procedurally, control over large mergers will move from the national capitals to Brussels. On the substantive side, the laws, and hence the criteria, under which mergers will be evaluated will be different from those applied at the member states' national level.[35]

As noted above, because this controversial proposed regulation is still in a draft stage, which observers predict will undergo further revision, discussion of specific changes in European merger control that may result from this particular draft of the Merger Regulation is speculative. Therefore, this section will focus on what are considered to be the controversial aspects of the Merger Regulation and changes that may be brought about by the enactment of the proposed regulation, depending on the resolution of the outstanding issues.[36]

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[21] Commission of the European Community *Fourteenth Report on Competition Policy* (1984), pp. 81 to 83.
[22] Interview with Prof. Barry Hawk, Professor of Law, Fordham University Law School, Mar. 20, 1989 [hereinafter "Hawk Interview"].
[23] Hawk Interview.
[24] It is important to note that art. 3 of the Merger Regulation uses the term "concentration" broadly to include 100 percent takeovers as well as partial takeovers and "transactions resulting in the acquisition of 'control'." Burnside, Alec "Merger Control with a European Dimension The Draft Regulation," *International Business Lawyer* p. 351 (September 1988)[hereinafter "Burnside"].
[25] Merger Regulation, art. 1(1).
[26] A European Currency Unit is a unit of currency based on a basket of European currencies. It is used for accounting purposes only and is currently valued at about $1.10. This "upper threshold" is still an issue of ongoing debate. Although the current draft puts the upper thresholds at 1,000 million ECU, Sir Leon Brittain, the EC commissioner for competition policy, agreed to raise the threshold to 2,000 million ECU in an effort to get approval. USITC staff meeting with a member of Directorate General IV, Competition, of the EC Commission [hereinafter "DG IV"], Apr. 17, 1989.
[27] Merger Regulation, art. 2(1).
[28] As with the upper threshold limit, the "single member state criteria" has been changed from the figure of three fourths in the current draft to two thirds.
[29] Merger Regulation, art. 4(1).
[30] Merger Regulation, art. 20(1) and recital 27. See also section on "Exclusive Community Control," below.
[31] Merger Regulation, art. 2(2).
[32] Schroter Address, p. 6; Merger Regulation, art. 2(3).
[33] Merger Regulation, art. 8(2).
[34] Merger Regulation, art. 2(2).
[35] Many expert comparisons of national competition laws to EC law have been published. See Vaughan, David, ed., *Law of the European Communities* (London: Butterworths, 1986), pt. 19; Hawk, *A Comparative Guide*.
[36] The one major change that is not discussed is the requirement in art. 4 that the EC Commission be notified of all mergers. This provision has not engendered tremendous controversy, most probably because mergers are already notified to the EC Commission, albeit on a voluntary basis.

Scope

The first area of controversy in the proposed regulation is article 1, which defines the scope of the Merger Regulation. The current discussions on the upper threshold[37] are centering around a 2,000 million ECU figure, with a proposal to phase in the regulation by raising the upper threshold to 5,000 million ECU until January 1, 1993, at which point it will decrease to 2,000 million ECU.[38] Some member states want the threshold raised as high as 10,000 million ECU[39] and one EC Commission official predicted that it might go that high.[40]

The thresholds, and hence how many mergers will fall within the jurisdiction of the EC Commission, are controversial for a number of reasons. The question of which mergers should be subject to national as opposed to EC jurisdiction is a very sensitive one. Some member states (e.g., France, the United Kingdom and West Germany) are not only jealous of their own jurisdiction but are also afraid of the approach the EC Commission may take to merger control.[41] On the other hand, some countries without national merger-control laws (e.g., Italy) appear to be content to delegate this authority to the EC Commission rather than develop their own merger legislation.[42] Some European officials interviewed by USITC staff claimed that it is not in the least a question of the willingness of member states to surrender jurisdiction, but merely a question of how many investigations DG IV will be able to handle.[43] If the EC Commission does not have adequate staff to properly investigate each merger, it is feared that decisions will either be arbitrary or based on other than pure competition criteria. Another reason for concern, as expressed by some German attorneys, is that the larger mergers falling within the scope of the Merger Regulation will face an easier process at the EC Commission (perhaps because of the less nationalistic approach or because of the lack of time for truly indepth investigations), whereas smaller mergers will face tighter control before national competition authorities, such as the *Bundescartellamt* (the West German federal cartel office).[44]

Another, more technical, aspect of the threshold issue is the reliance on "turnover"[45] asthe central criterion for EC jurisdiction. The Germans, claiming support of the British, have expressed a preference for the use of market share to determine which mergers have a Community dimension.[46] Representatives of British industry, however, expressed support for the use of turnover because of the ease of calculation.[47] An official in DG IV admitted that the impact on competition does not necessarily rise with an increase in turnover, but the intent was to provide a straightforward dividing line to clearly indicate which mergers would fall within the scope of the Merger Regulation and that line was clearer using turnover figures than trying to calculate market share.[48]

Exclusive EC Commission ontrol

Article 20(1) provides that if a merger comes within the scope of the Merger Regulation, the EC Commission will have exclusive jurisdiction. Many people familiar with the merger debate support "one-stop shopping,"[49] which would eliminate the difficulty and expense of notifying the various national authorities involved.[50] It is still uncertain, however, whether one-stop shopping is either the actual intent of the EC Commission or a realistic option. It is widely accepted that if the EC Commission prohibits a merger, a member state cannot then allow it.[51]

[37] See footnote 26, above.
[38] USITC staff meeting with a member of DG IV, Apr. 17, 1989.
[39] Schroter Address, pp. 12 to 13; USITC staff meeting with a member of DG IV, Apr. 17, 1989.
[40] USITC staff meeting with a member of DG IV, Apr. 17, 1989. It is possible that a merger between two U.S. companies would fall within the scope of the regulation, mandating prior notification of the merger. Whereas the definition of "Community dimension" in the May draft referred to undertakings with their principal fields of operations in different member states, the current Merger Regulation contains no such EC residency requirement. Thus, if the worldwide and EC sales figures of two merging U.S. companies were above the thresholds, even if they had no presence whatsoever in the EC, the EC Commission could claim jurisdiction over the merger. Although the EC Commission might not have the ability to prevent a merger between U.S. companies, it might be able to exercise control over activities of any subsidiaries of those companies located in the EC.
[41] See sec. 3 on "Substantive Criteria," below.
[42] U.S. Department of State Telegram, 1989, Rome, MESSAGE REFERENCE No. 12593.
[43] See USITC staff meetings with a member of DG IV, Apr. 17, 1989, and with British attorneys, Apr. 20, 1989.
[44] USITC staff meeting with German attorneys, Apr. 26, 1989. It is true that in those few (and getting fewer) countries that do not have merger-control laws mergers below the thresholds would face no control at all.
[45] The proposed regulation utilizes the term "turnover" which is generally equivalent to total sales. See Merger Regulation, art. 5.
[46] USITC staff meetings with members of the German Ministry of Economics, Apr. 27, 1989; and with a British attorney, Apr. 20, 1989. (The British attorney, among others, pointed out that the threshold levels were "chosen out of the air" and bore no relation to dominant position or competitive impact.)
[47] Lords Report, p. 31.
[48] USITC staff meetings with a member of DG IV, Apr. 17, 1989; and with a member of the French Conseil de la Concurrance, Apr. 24, 1989. See also Lords Report p. 16.
[49] If the EC Commission had exclusive jurisdiction, companies seeking to merge would be required to seek approval from only one authority rather than petitioning the individual member states. See, e.g., Lords Report, p. 29.
[50] U.S. companies may still have to notify national governments under foreign investment laws. See e.g., the French law on foreign investment, Law No. 66 1008 of Dec. 28, 1966, as amended; Decree No. 67-78 of Jan. 27, 1967, as amended; Arrete of July 26, 1974, as amended. *Common Market Reporter*, par. 22,631 et seq.
[51] Burnside, p. 354; Hawk Interview.

But if the EC Commission authorizes the merger or is silent on the matter, the question remains to what extent, if at all, the member states may still apply their national laws to the merger.

Although in his recent proposals Sir Leon Brittan, the EC commissioner in charge of competition, suggested that all mergers that fall within the scope of the Merger Regulation will be under the sole jurisdiction of the EC Commission,[52] the current draft provides two exceptions to this exclusivity. Article 8(2) in conjunction with article 20(2) allows member states to review a merger that has already undergone EC Commission review, but only in order to assess the competitive effect of the merger on a local level and only if permitted to do so by the EC Commission. Dr. Schroter, head of the Section for Legal and Procedural Questions of DG IV, has asserted that the EC Commission must approve member-state review of the merger if it ascertains that such intervention "will not impede the carrying out of the merger as such, but only adjust certain of its effects."[53] A German attorney, on the other hand, claimed that the provision is unconstitutional because the EC Commission cannot regulate when member states may or may not apply their laws.[54] Article 8(2) specifically allows member states to apply "national legislation on competition" whether or not such legislation includes noncompetition criteria. Although the EC Commission will control which mergers will fall to the member states to review, sources in the mergers field fear this provision could provide a means through which member states will apply industrial policy in the guise of competition law.

The second exception to EC Commission exclusivity is article 20(3), which allows member states to take appropriate measures to protect their legitimate interests other than competition.[55] There seems to be a debate as to just how large this loophole may prove to be. Some British attorneys have opined that the exception is narrow and that "legitimate interests" invokes the French notion of "ordre public."[56] Yet former EC Commissioner Sutherland[57] stated that article 20(3) may be used by national authorities "to make decisions in respect of general policy issues."[58] If former EC Commissioner Sutherland is correct, article 20(3) may provide member states with a lawful means of circumventing the exclusive control of the EC Commission over mergers with a Community dimension.[59]

Both exceptions, in conjunction with the extensions of articles 85 and 86 of the treaty discussed below, have created concern that the Merger Regulation does not solve the problem of double jeopardy.[60] It is hoped that the final draft of the Merger Regulation "will state in express terms when, if at all, national controls may be applied."[61]

Substantive criteria

Perhaps the most controversial aspect of the merger proposal centers on the discussion of what criteria will be used in assessing whether to allow or prohibit a merger. The fear is that the EC Commission will use antitrust enforcement to pursue industrial policy objectives.[62] For example, there is a concern that when evaluating a merger, the EC Commission will look not only at what effect the merger will have on the market structure (i.e., market share, price power, and barriers to enter), but also at what role the companies concerned play in the local or EC economy (i.e., employment, regional development, and EC integration).

This is a disagreement over philosophy, with the United Kingdom and West Germany leading the contingent that thinks mergers should be assessed purely on competition grounds.[63] France, on the other hand, leads among those member states that want to include industrial and social policy considerations[64] as part of the

[52] USITC staff meeting with a member of DG IV, Apr. 17, 1989.
[53] Schroter Address, p. 10.
[54] USITC staff meeting with a member of the Bundesverband der Deutschen Industrie (the German Federation of Industry)[hereinafter "BDI"], Apr. 28, 1989.
[55] Ensuring the existence of a viable defense industry, maintaining plurality in the media, and enforcing prudential rules in the banking and insurance industries are recognized as legitimate state interests. Schroter Address, p. 10.
[56] USITC staff meetings with British attorneys, Apr. 20, 1989. "Ordre Public" connotes law and order with public policy overtones.
[57] Sutherland was the EC commissioner in charge of competition policy before Brittan assumed that portfolio.
[58] Lords Report, p. 20.
[59] See Schroter Address, p. 10.
[60] USITC staff meetings with a member of DG IV, Apr. 17, 1989; with a British attorney, Apr. 20, 1989; and with a member of BDI, Apr. 28, 1989. See also, Burnside, p. 354.
[61] Burnside, p. 354.
[62] RIIA Paper, p. 11. For comparison to U.S. antitrust, see Hawk, Barry "The American (Antitrust) Revolution Lessons for the EEC?" 9 *European Competition Law Review*, p. 53 (1988).
[63] See Lords Report, pp. 32 to 33; USITC staff meetings with a British attorney, Apr. 20, 1989; with members of the Competition Policy Division, British Department of Trade and Industry [hereinafter "DTI"], Apr. 20, 1989; with members of the German Ministry of Economics, Apr. 27, 1989; and with a member of BDI, Apr. 28, 1989. See also U.S. Department of State Telegram, 1989, Rome, MESSAGE REFERENCE No. 12593.
[64] France wants the EC Commission to consider, in addition to purely competition factors, issues such as what the effect will be on local employment, regional development, development of a "European champion," and protection of local brands (i.e., national symbols). USITC staff meeting with members of the French Direction Generale de la Concurrance et de la Repression des Fraudes (Office of Competition and Elimination of Fraud), Apr. 24, 1989.

evaluation.[65] Spain and Portugal claim they are not yet industrialized and want to encourage concentrations.[66]

Some people familiar with the Merger Regulation expressed concern that unless the language of the Merger Regulation establishes a pure competition test, it may not ever be clear whether EC Commission decisions are based on competition grounds or industrial/political grounds.[67] Although British and German experts agree (reluctantly) that industrial and social issues could have a part in the final analysis, as evidenced by the loophole available in article 20(3), initially the determination should be solely on competition grounds.[68] Thereafter, if a member state must block the merger on political grounds, the decision should be recognized as such and not disguised as an antitrust decision.

One DG IV official was unsure whether or not the EC Commission would consider industrial policy in evaluating mergers. If it did, however, he predicted that (1) a merger of two companies that enjoy a duopoly might be allowed in order to compete against U.S. companies or (2) U.S. companies might face actual discrimination to prevent U.S. acquisitions in sensitive areas such as high technology or defense. The official opined that the latter case was less probable than the former.[69]

The president of the *Bundescartellamt* has advanced the idea that a body independent of the EC Commission be created to make the competition decision.[70] British officials, wary of yet another layer of bureaucracy, opined that a separate antitrust body would be impossible, as it would require an amendment to the Treaty or Rome.[71] Such a body might better parallel some domestic systems in which the decision as to whether a merger would have an anticompetitive effect is made independently of the political decision, which may involve social, employment, regional, and industrial considerations. Although not yet formally discussed in the EC Commission, an independent body might assuage worries by making an initial decision on competition grounds while allowing a subsequent—and overriding—political decision to be made on other grounds (i.e., social or industrial grounds).

Articles 85 and 86

Once a merger control regulation is passed, the existence and continued applicability of articles 85 and 86 pose a problem. Constitutionally, a regulation cannot change the treaty; therefore, articles 85 and 86 will continue in force.[72] The EC Commission has attempted to limit the applicability of articles 85 to 86 by drafting the Merger Regulation to ensure that any merger with a "Community dimension" will be assessed only under the terms of this regulation (or its successor).[73] As noted above, Sir Leon Brittan has attempted to make it clear that any merger with a Community dimension will be covered by the Merger Regulation, the implication being that they will not be subject to attack under articles 85 and 86. Uncertainty remains however in two areas: (1) mergers that fall below the thresholds, and (2) private actions in national courts challenging a merger on the basis of articles 85 and 86.

The assumption has been that national law will apply to those mergers falling outside the scope of the EC Merger Regulation.[74] But because the Merger Regulation does not disapply regulation 17, individuals may continue to rely on articles 85 and 86 in challenging a merger without a Community dimension in actions before the EC Commission on the basis that the merger violates the Treaty of Rome and that the EC Commission has jurisdiction because the merger will affect intra-EC trade. Under the terms of the proposed regulation, the EC Commission should refuse jurisdiction for lack of a Community dimension. The EC Commission has given its assurances that it will decline to exercise its jurisdiction over mergers that do not have a Community dimension. Nevertheless, many wonder whether, because the EC Commission has the competence to hear such cases, it will not some day decide to invoke its authority to do so.[75] Furthermore,

[65] USITC staff meetings with an attorney from Coudert Freres and a member of the Office of Prime Minister Rocard of France on Apr. 24, 1989; and with a member of the French Conseil de la Concurrance (Competition Council), Apr. 24, 1989.
[66] Speech given by Jonathon Faull, American Bar Association Conference on Banks and Banking in Europe after 1992. Feb. 24, 1989 [hereinafter "Faull's Speech"].
[67] USITC staff meeting with members of Competition Policy Division, DTI, Apr. 20, 1989; with members of the British Office of Fair Trading, Apr. 20, 1989; and with a member of BDI, Apr. 28, 1989.
[68] USITC staff meetings with a member of DG IV, Apr. 17, 1989; and with a member of BDI, Apr. 28, 1989.
[69] USITC staff meeting with a member of DG IV, Apr. 18,1989.
[70] See the Ahmed Saeed case; Lords Report, pp. 8 to 9; USITC staff meeting with a member of BDI, Apr. 28, 1989.
[71] USITC staff meeting with members of the Competition Policy Division, DTI, Apr. 20, 1989.
[72] Faull's Speech.
[73] Faull's Speech. See also Schroter Address, p. 14; USITC staff meeting with a member of the French Conseil de la Concurrance, Apr. 24, 1989.
[74] USITC staff meetings with a member of DG IV, Apr. 17, 1989; and with an attorney from Coudert Freres and member of the Office of Prime Minister Rocard of France, Apr. 24, 1989.
[75] Much of this debate centers on the future interpretation of the Philip Morris case. One view holds that Philip Morris can not be expanded to cover full mergers because art. 85 addresses anticompetitive behavior between firms, but if the firms merge, the concept is inapplicable. USITC staff meeting with a member of the Federation of German Industry, Apr. 28, 1989. Others believe that the EC Commission knew exactly what it was doing when it expanded art. 85, as did the ECJ when it upheld the decision, and that the EC Commission will continue its expansionary trend. USITC staff meetings with a member of DG IV, Apr. 18, 1989; and with members of the German Ministry of Economics, Apr. 27, 1989. With the recent decision by

whereas some think that the Philip Morris case cannot be expanded to include full mergers,[76] others are certain that the EC Commission intended to broaden the scope of article 85 and will continue to do so as necessary.[77] Nevertheless, even if the EC Commission does exercise restraint, undertakings[78] still face the possibility of challenge in a national court that may apply national law, EC law, or both.[79]

If the EC Commission does refrain from applying articles 85 and 86 to a merger falling within the scope of the Merger Regulation, there is no guarantee that private litigants will exercise the same restraint. Because articles 85 and 86 cannot be eliminated, individuals can continue to invoke articles 85 and 86 in private actions in domestic courts.[80] Although Dr. Schroter has predicted that parallel proceedings, in the EC Commission and in a domestic court, will be unlikely,[81] many others have expressed the fear that the Merger Regulation is not clear enough in defining the limits of the EC Commission's jurisdiction. In short, it appears that notwithstanding the desire of some people to limit the role of articles 85 and 86, these articles may continue to play a role in the evaluation of mergers in the EC.[82]

Summary of Possible Effects[83]

U.S. exports to the EC

The European Community is an important market to the United States not only in commodity sales but also in terms of direct investment. U.S. exports to the European Community since 1985 have grown at nearly one and a half times the rate of U.S. exports in total. In 1988, EC markets received about a fourth of the $308 billion in goods exported by U.S. companies. Similarly, U.S. direct investment in the EC increased by 51 percent during 1985–87, whereas total U.S. direct investment abroad increased by only 34 percent. In 1987, 40 percent of the $309 billion invested abroad by U.S. companies was spent in the European Community.

Reportedly, U.S. companies spent an estimated $2.4 billion acquiring European companies in 1987. In contrast, European companies spent $37.1 billion acquiring companies in the United States that year.

U.S. exports could be affected positively or negatively depending on the direction taken by the EC on mergers and acquisitions. If the EC encourages mergers or acquisitions by EC companies but discourages these activities by U.S. firms that import intermediate products from the United States, European firms could become more efficient and more competitive. If, on the other hand, U.S. firms increase their market share through mergers and acquisitions and import more intermediate products from the United States to be used in their European operations, U.S. exports could increase. In addition, U.S. companies that do not manufacture in the EC could face increased competition if merger activity leads to efficiencies and, consequently, to more competitive products' being produced in the EC. The general consensus seems to be that the overall effect of this Merger Regulation will be trade neutral.

Of the six industries sampled for the concentrations regulation, five are in the manufacturing sector (food processing; air-conditioning, refrigeration and compressors; computer and data processing equipment and software; aircraft and aircraft engines and parts; and grain and oilseed processing), and one is to services (financial services). For these industries, the effects of this regulation on their exports is not expected to be significantly trade liberalizing.

Briefly stated, the U.S. food processing industry exports relatively little to the EC ($173 million in exports to the European Community compared with $143 billion in domestic shipments in 1988). Most U.S. companies manufacture these products through subsidiaries in the European Community to satisfy local tastes. U.S. producers of air-conditioning products also manufacture in the EC. Although most U.S. producers rely on exports to service the EC market, it is estimated that 20 percent of U.S. companies in this sector have subsidiaries in the EC that manufacture at least one line of a product. In fact, one of the factors contributing to the sharp increase in U.S. exports to the EC during 1984–88 was an increase in interplant shipments between U.S. plants and their affiliated firms in Europe. U.S. exports to the EC of air-conditioning products increased from $111 million in 1984 to $365 million in 1988.

U.S. exports of computer equipment to the EC totaled about $10 billion in 1988, more than half of which was parts for computers. It is estimated that IBM's market share in the EC for mainframe computers ranges from 50 percent to 60 percent and for all information technology it has a 15-percent market share. Also, most of IBM's mainframe computers sold in the EC are

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[75]—*Continued*
the ECJ in the Ahmed Saeed case to outlaw price fixing in the previously excluded sector of air transport, (see note 12, above) it appears that the ECJ supports the expansion of the EC Commission's jurisdiction.
[76] USITC staff meeting with a member of the Federation of German Industry, Apr. 28, 1989.
[77] USITC staff meeting with a member of DG IV, Apr. 18, 1989, and with members of the German Ministry of Economics, Apr. 27, 1989.
[78] For the purposes of the Merger Regulation, an "undertaking" means any type of company or business.
[79] Schroter Address, p. 14.
[80] Burnside, p. 354.
[81] Schroter Address, p. 14.
[82] Hawk Interview.
[83] The worksheets of the individual analysts can be found at the end of this section.

made there. The United States is a major supplier of aircraft to the EC. In general, no EC firms make products to compete with U.S. exports. Seventy-five percent of the EC's civil transport aircraft fleet was built in the United States.

Grains and oilseeds are exported to the EC for the processing industry. And even though a large portion of the processing is done by U.S.-owned companies, U.S. exports of grains and oilseeds are not expected to increase significantly because of competition from EC products.

Because financial institutions provide a service instead of a product, commodity exports per se do not exist in this market. Coordination and standardization of regulation could, however, prove to be a stimulus to activity in this sector.

Diversion of trade to the U.S. market

This Merger Regulation is not expected to result in trade diversion. For the industries sampled, trade in the particular product is either relatively small or U.S. companies are generally competitive in the product.

U.S. investment and operating conditions in the EC

The Merger Regulation establishes criteria to narrow the EC Commission's review to only those activities with a "Community dimension." Many U.S. firms investing abroad are believed to be large multinationals, some already operating manufacturing facilities in Europe. Therefore, it is likey that the merger activity of these large firms will fall within the scope of the Merger Regulation. As a result, some industry sources have voiced concern that the regulation is too vague, that it gives the EC Commission discretionary power, and that EC firms may be favored over non-EC firms.

U.S. companies seem to be responding to the European initiatives by restructuring prior to 1992. U.S. companies announced plans for 138 acquisitions (valued at $14.5 billion) during the first 9 months of 1988, compared with 203 announced plans ($6.8 billion) in all of 1987 and 44 ($0.8 billion) in 1984.[84] In food processing, H.J. Heinz Co., a $5 billion company, intends to spend $1 billion to increase its EC market share, including by means of acquisitions. In the air-conditioning industry, since many U.S. companies already have manufacturing subsidiaries in the European Community, the cross-border merger regulation might be more applicable.

IBM is the dominant computer-equipment manufacturer in the EC, and it is unlikely that a merger with or acquisition of another major EC-based equipment manufacturer would be approved. On the other hand, the larger EC-based computer companies could also be prevented from merging and possibly becoming more competitive with IBM. Working arrangements between U.S. and EC firms are likely to become more commonplace in future jet-engine development. However, outright mergers in the aerospace industry do not seem likely, given national interests and especially, national security concerns.

In grains and oilseed processing, significant concentration has already taken place in the EC. In addition, economic conditions within the industry discourage further investment at this time. U.S. trade association sources indicate that three U.S. firms hold 60- to 70-percent market share in oilseeds. In corn and other grains, the U.S. share is not quite as large, but still substantial. Standardization of operating conditions in financial transactions could liberalize operating conditions for these firms.

Representative Industries

This ends the general discussion of the proposed regulation on merger control. Following are individual discussions of the sectors/industries listed below:

- Processed foods
- Air-conditioning, refrigeration, and compressors
- Computer and data processing equipment and software
- Aerospace
- Grains and oilseeds
- Financial services

The reader should see the chapter table of contents for the specific page locations of the above analyses that are of interest. Following these industry analyses, additional directives/ regulations are analyzed.

Processed foods

Possible effects.—

U.S. exports to the EC.—The Merger Regulation is not expected to have a significant impact on U.S. exports of processed foods to the European Community. Most U.S. processed-foods manufacturers that sell to the EC market conduct such sales from manufacturing subsidiaries or affiliates operating in the EC rather than through direct exports.

U.S. shipments of processed foods are estimated to have totaled $143 billion in 1988. Total U.S. exports of processed foods in 1988 amounted to about $1.5 billion. Of these exports, 12 percent ($173 million) went to the EC, 16 percent went to Canada, and 19 percent went to Japan. In contrast, sales of food and

[84] Arterian, Susan, "1992 Fever Crosses the Atlantic," *Global Finance* (November 1988).

kindred products by U.S. affiliates within the EC were estimated at approximately $18 billion in 1985 (the latest data available); similar sales within Canada amounted to $6 billion, and within Japan amounted to $3 billion. These data suggest that U.S. manufacturers of processed foods more frequently operate through subsidiaries or affiliates within the EC than directly export their goods to the EC.

The reason sales by subsidiaries or affiliates within the European Community might be preferred to exports to the European Community is related to the nature of the products. Most processed foods are perishable to some extent, so quality is better maintained if transit time to the ultimate consumer can be reduced. In addition, most processed foods are market specific and highly subject to cultural influences. The types of processed foods that appeal to U.S. consumers do not necessarily appeal to European consumers; in fact, the types of processed foods that appeal to French consumers do not necessarily appeal to German consumers. Given the divergence in and changeable nature of consumer tastes and preferences in processed foods, it is easier to serve a particular market if a producer is located in close proximity to that market. Finally, some processed foods, especially in the sauces and beverages sectors, are relatively expensive to ship. Transportation costs can be drastically reduced if the distance between the factory and the market is reduced.

The effect of the Merger Regulation on trade should be minimal. If U.S. firms already operating in the EC wanted to increase market share or establish themselves in another EC member country for the first time and were blocked from doing so by this regulation, they might increase their exports from the United States instead. If this Merger Regulation were to be used to limit acquisitions, U.S. companies not already present in the EC would have to export from the United States to enter the EC market. U.S. companies already producing in the EC would be able to continue shipping from their existing EC facilities.

Diversion of trade to the U.S. market.—This Merger Regulation should cause few exports from other non-EC countries to be diverted from the EC to the United States. Even if the exports of other non-EC suppliers were to be diverted to the U.S. market, in most cases it would mean merely an increase in existing exports. The U.S. market is one of the largest markets for processed foods and receives exports from all over the world. It is likely that any indirectly caused diversion of exports to the U.S. market would be a marginal increase. Such an increase would be subject to the limitations imposed by differences in tastes and preferences between the United States and the EC and by transportation costs, as discussed earlier.

U.S. investment and operating conditions in the EC.—The Merger Regulation could have a significant adverse impact on future U.S. investment in the European Community, and some adverse impact on future business operating conditions in the EC but little if any effect on existing investment.

Total assets of the affiliates of U.S. food and kindred products companies in the EC-10 (excluding Spain and Portugal) in 1985 were estimated to be $16 billion. Although no more recent data are available, it is believed that such assets are considerably larger at present. This growth indicates that a substantial amount of mergers and acquisitions by U.S. companies have already taken place in the European Community and that such activity has continued to the present. The U.S. companies that have operations in the EC are some of the largest processed-food concerns in the world. U.S. companies that have operations in most of the EC countries include Beatrice Companies, Inc.; Campbell Soup Co.; Canada Dry International Corp.; The Coca-Cola Co.; CPC International, Inc.; General Foods Corp.; Kraft, Inc.; Nabisco Brands, Inc.; Procter and Gamble Co.; Ralston Purina Co.; and Weight Watchers International, Inc. (owned by H.J. Heinz Co., which also has other operations in the EC). The EC market is a major market for these companies, and these and other companies are expected to continue merger and acquisition activities.

Most EC and non-EC processed-food concerns that are already established in the EC market will fall within the scope of this regulation in terms of both the size of the companies involved (measured in terms of sales volume) and the extent to which these companies currently have operations in more than one of the EC member countries. Since mergers are the means by which these companies established themselves and grew in the EC market, this regulation could restrict further growth that cannot be accomplished by increased sales.

Smaller companies that do not meet the sales volume required by this Merger Regulation will not be restricted in their merger activity; this provision could favor EC companies because a lack of resources may limit the ability of smaller non-EC companies to enter the EC market through mergers. The regulation also gives the EC Commission the discretion to approve mergers that would otherwise be prohibited by this Merger Regulation, if the EC Commission finds that such a merger otherwise furthers the goals of a single European market. The concern is that such discretion may favor EC companies over non-EC companies.

U.S. industry response.—The trade press has reported the actions that various U.S. companies are taking in anticipation of the single European market in 1992. There are no indications that these actions are in direct response to this Merger Regulation. However, it is likely that the major processed-food concerns will be taking actions in order to maintain European market share.

H.J. Heinz Co. is the owner of Starkist, one of the largest EC tuna processors; is strong in the EC market in ketchup, baby food, and canned soups, to name a few products; and is also large in diet meals through its Weight Watchers line. Heinz, a $5 billion company, has stated that it intends to spend up to $1 billion to increase its EC market share, including through acquisitions, by 1992. In the EC, Heinz is primarily competing in most processed foods against two firms, each about six times its size—Nestle, a Swiss company, and Unilever, a British-Dutch company.

The Coca-Cola Co. has restructured its worldwide management to isolate and put more emphasis on the EC. Coca-Cola has started building one of the world's largest canning plants in France, has consolidated bottling operations, and has terminated some licensing agreements to market its soft drinks itself. All of these actions were designed to take advantage of Europe as a growth market.

Sara Lee Corp., which has sales of $3.5 billion in Europe, is pursuing acquisitions to enhance its European position. These acquisitions include a Dutch coffee and tea company and a French pantyhose manufacturer. Also, Sara Lee, Gillette Co., and Procter and Gamble Co. are experimenting with "Euro-branding"—putting several languages on a single package that is distributed to several different countries.

Most U.S. processed-foods manufacturers are actively planning for 1992, taking measures now to increase or establish market share. In certain instances, current actions are being taken because any growth after the adoption of this regulation (such adoption could precede 1992) could be slowed. The ultimate impact of this regulation on growth, especially through mergers, is unclear.

Views of interested parties.—No formal submissions were received.

Air-conditioning, refrigeration, and compressors

Possible effects.—

U.S. exports to the EC.—The Merger Regulation will most likely have a neutral impact on the U.S. industry producing air-conditioning, refrigeration, and compressor products for the EC. However, small and medium-sized U.S. producers anticipate that this regulation is very likely to minimize the number of mergers between large producers in the EC.

During 1984–88, U.S. exports of these products worldwide increased from $1.6 billion in 1984 to an estimated $2.3 billion in 1988, or by 46 percent. During this same period, U.S. exports of these products to the EC also increased from $111 million in 1984 to $365 million in 1988, or by 229 percent. The principal foreign export markets for air-conditioning, refrigeration, and compressors during 1988 were Canada, Saudi Arabia, and Mexico. Collectively, these three nations accounted for 60 percent of total U.S. exports of these products. The bulk of U.S. exports worldwide and to the EC consisted of various types of compressors, parts, and unitary equipment. Furthermore, U.S. and Japanese producers jointly account for an estimated 70 percent of the world market share for air-conditioning, refrigeration, and compressor equipment. The EC (principally West Germany and Italy) accounts for an estimated 15 percent of the world market.

The bulk of U.S. producers of these products depend on exports to service the EC. For this reason, any large mergers between European firms producing these products are most likely to result in increased product competition in certain functional areas of this industry (i.e., fractional refrigeration compressors).

However, industry sources estimated that 20 percent of all U.S. air-conditioning, refrigeration, and compressor firms presently maintain European operations. Nearly all major producers of air-conditioning, refrigeration, and compressor products in Europe manufacture a single or limited number of product lines for this market. Although no single U.S. firm dominates the EC market for air-conditioning, refrigeration, and compressor products, the recent acquisition of a large French compressor firm by a U.S. producer of these products is most likely to make this firm the leading supplier in the EC.

Industry sources, citing the automatic-controls industry in particular, state that U.S. refrigeration firms exporting to the European Community are at a disadvantage because of their smaller size and recent entry into the market in competing with several of the larger European firms. In recent years, several of the larger refrigeration firms in Europe have acquired a small number of U.S. firms presently producing such components as automatic controls for central air-conditioning units, and they are currently reexporting these products to the EC and other global markets.

U.S. exports in 1988 of these products are listed in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	365
Japan	111
Canada	602
World	2,318

Exports to the EC constitute 16 percent of all U.S. exports of such products.

Diversion of trade to the U.S. market—The Merger Regulation is most likely to have a neutral impact on U.S. industries producing air-conditioning, refrigeration, and compressor products. Because both the United States and Japan account for approximately 70 percent of world market share, coupled with a mature market for these products in the United States, third-country exports are not likely to be a potential problem.

U.S. investment and operating conditions in the EC.—In 1987, U.S. direct investment in the EC for manufacturing machinery except electrical (which includes air-conditioning, refrigeration, and compressor products) amounted to $3.9 billion. U.S. manufacturing investment in the EC for these products is estimated to be nearly $415 million.

Presently, the majority of U.S. producers of air-conditioning, refrigeration, and compressor products export these products to the European Community. Nearly all U.S. producers of these products are at a distinct competitive disadvantage as a result of incurring higher transportation costs and tariff rates. Furthermore, firms interested in producing for the EC market have had to deal with 12 different sets of trading regulations and product-design requirements. In addition, the high cost of establishing facilities in the EC primarily to serve small national markets has previously limited U.S. manufacturing investment.

Industry sources indicate that the Merger Regulation is likely to lead to increased European mergers and acquisitions that will result in increased economies of scale. This could lead to increased competition for U.S. firms exporting to or producting in the EC. Also, because U.S. firms possess more advanced technology in some areas, mergers or cooperative agreements between U.S. subsidiaries in the EC and European firms may become more common.

U.S. industry response.—Nearly all institutions surveyed indicated concern with having to receive prior approval and with the time taken up by the EC Commission in merger controls. Additional concerns focused on EC firms being more competitive in the U.S. market. Furthermore, several medium-sized firms were concerned with increased European acquisitions by large U.S. producers.

U.S. firms producing these products anticipate incurring more arduous delays in complying with future EC directives, which are likely to restrict export of these products (e.g., national-content requirements). This action has influenced several medium and small-sized air-conditioning, refrigeration, and compressor producers to better serve this market by entering into joint-venture or licensing agreements with suitable European firms. This regulation may limit the ability of these companies to invest in the European Community. Furthermore, this regulation may serve to hinder U.S. subsidiaries in realizing economies of scale in the EC market. However, it may also benefit those U.S. subsidiaries that have a significant presence by limiting the manufacturing investment of other non-EC countries.

Views of interested parties.—No formal submissions were received.

Computer and data processing equipment and software

Possible effects.—

U.S. exports to the EC.—U.S. exports of computer equipment totaled about $22 billion in 1988. Exports to the European Community in 1988 were almost $10 billion, or about 45 percent of total U.S. exports. U.S. production is estimated at $54 billion in 1988, hence the ratio of exports to the EC to U.S. production is almost 20 percent. U.S. exports of complete computers and peripheral units accounted for about 49 percent of the total, with exports of parts of computers and peripherals accounting for the remaining 51. About 45 percent of U.S. exports to the EC were complete units, and the remaining 55 percent were parts. Estimates of the market share held by IBM, the largest U.S. computer firm in the EC, range from 50 to over 60 percent of the market for mainframe computers. It is estimated that 90 percent of IBM's mainframe computer sales in the EC are also produced there. IBM is estimated to have 15 percent of the total market for all information technology (hardware, software, and services) in the European Community. Any effect that the Merger Regulation would have on U.S. exports to the EC is likely to be limited due to the size of IBM's market share in the EC and its high level of EC-based manufacturing of the equipment it sells there.

Diversion of trade to U.S. market.—In 1987, imports of computer and data processing equipment from the United States into the European Community accounted for almost 70 percent of the total value. EC imports from Japan accounted for about 25 percent. Any diversion of Japanese exports from the EC to the U.S. market as a result of the application of the Merger Regulation is expected to be small since a number of computer manufacturers in the EC rely on Japanese technology for their equipment.

The production of Automated Data Processing (ADP) machines in the United States and the rest of the world is dominated by IBM. Industry sources estimate that IBM, through its large foreign subsidiaries, accounts for more than 30 percent of world sales of ADP machines. In addition, IBM, along with 16 other U.S. firms, accounted for approximately one-half of world sales in 1987. Given that U.S. firms have such a

large share of world sales, the likely impact on the U.S. industry of any trade diversion from the EC as a result of the Merger Regulation is expected to be small.

The basic designs for ADP machines originate in the United States, and U.S. firms are dominant in the production of software. U.S. dominance in software has been brought about in part because English is widely used in international transactions. The strongest challenge to U.S. dominance in the production of ADP machines comes from Japan, where three large firms are emerging as strong competitors. Challenges are also coming from two large firms in Western Europe—one in West Germany and another in Italy. Certain developing countries in the Far East have the potential to become world suppliers.

U.S. investment and operating conditions in the EC.—The Merger Regulation requires that mergers that have a "Community dimension" be examined for possible anticompetitive aspects. Because of the size of IBM, it is quite likely that any merger in which it became involved would fall within the scope of the regulation. The Merger Regulation could have an adverse effect on future U.S. investment in the EC if such investment were in the form of mergers or acquisitions. Since IBM is the dominant computer-equipment manufacturer in the EC, it is unlikely that a merger with another major EC-based equipment manufacturer would be approved. However, the regulation does not appear to adversely affect the present level of U.S. investment. The impact of the Merger Regulation could even be beneficial to U.S. investment in the EC if large, EC-based computer companies other than IBM were also prevented from merging to obtain a greater market share. IBM then would not face increased competition from a reorganized rival computer manufacturer that would be better able to exploit economies of scale. U.S. investment in computer-equipment industry in the EC was approximately $15 billion in 1987, according to Department of Commerce data. Over the past 2 years, IBM has invested almost $2 billion in the European Community.

U.S. producers of data processing machines tend to specialize in the production of such equipment; but because the computer industry and the telecommunications industry are increasingly difficult to separate, U.S. producers are beginning to supply equipment to both markets. IBM has acquired the Rolm Corp., a producer of telephone private branch exchanges,[85] and AT&T is currently selling in the merchant market a minicomputer that had been originally developed as a master controller for its central-office switches. In Japan and Western Europe, producers of ADP machines are integrated subsidiaries of large electrical and electronic firms. The blending of the telecommunications and computer industries tends to increase the size of the potential market for such products and further mitigates the possible effects on the U.S. industry as a result of trade diversion caused by the Merger Regulation.

U.S. industry response.—U.S. computer and data processing firms are making adjustments, such as forming joint ventures, in anticipation of the integration of the EC in 1992. These actions appear to be principally related to the desire of U.S. firms to consolidate their positions in the EC market or to streamline their organizations prior to 1992. Thus, these actions are a response to the proposed integration of the EC market in general rather than as a response to any particular directive such as the Merger Regulation.

Views of interested parties.—No formal submissions were received.

Aerospace

Possible effects.—

U.S. exports to the EC.—U.S. exports of aircraft, engines for aircraft, and parts for both are not likely to be affected by this regulation. Much of the EC aerospace industry is currently controlled by two companies, British Aerospace and Aerospatiale. These two conglomerates will probably be joined by Daimler-Benz (West Germany), which is seeking to absorb Messerschmidt-Boelkow-Blohm (MBB) (West Germany).[86] Following this merger, the majority of all EC aerospace companies will be controlled by these three entities.

U.S. exports to the European Community are not likely to be affected by this concentration of aerospace companies within the EC, as none compete with products offered by the U.S. aerospace manufacturers. The status of Airbus Industrie provides an example of the conditions of competition in the EC among aerospace companies. Unable to compete with U.S. aerospace manufacturers individually, EC airframe manufacturers (British Aerospace, Aerospatiale, MBB, and CASA of Spain) joined together in 1968 to form a cooperative venture, in

[85]—*Continued*
separate firms under a joint venture with Siemens. The official reported that after the contract is signed, the manufacturing operations at Rolm would be managed by Siemens and the sales and marketing operations would be managed jointly. Financial details of the proposed joint ventures have not been released. Telephone conversation with Mr. Siegel, IBM Government Relations Dept., June 28, 1989.

[86] In December 1988, IBM Corp. and Siemens AG (West Germany) signed a memorandum of understanding regarding the future of Rolm. Details of that memorandum are not available, but an official at IBM indicated to the USITC staff on June 29, 1989, that after current contract negotigations between IBM and Siemens are completed, Rolm would likely be reorganized into two

[86] Notwithstanding the recent decision by the *Bundescartellamt* that the Daimler Benz/MBB merger should be blocked on competition grounds, the expectation in both the private and public sector is that the government will allow the merger nonetheless.

which they would jointly assemble an aircraft built of subassemblies manufactured by each company, to compete with U.S. offerings. Airbus is the only entity in Europe that assembles aircraft designed to compete with the products offered by Boeing and McDonnell-Douglas, the two largest U.S. airframe manufacturers. However, Airbus receives substantial government assistance on a recurring basis, without which, it is speculated, Airbus could not continue to produce, or launch new programs. Although Airbus Industrie has sought risk-sharing partners in most of the countries possessing aerospace production facilities, none has been willing to form a joint venture with Airbus.

There will be no special benefits or disadvantages for U.S. exporters as a result of this regulation; thus, the effects are neutral insofar as the U.S. aerospace industry is concerned. In 1987, the EC held 20 percent of the world's large civil transport aircraft fleet, of which the preponderance (over 75 percent) were U.S.-built aircraft. This mix might change, however, if Airbus is successful in increasing capacity.

Diversion of trade to the U.S. market.—It is unlikely that trade would be diverted to the United States, since the U.S. aerospace industry is price and quality competitive and has significant production capacity. EC firms do not possess sufficient production facilities to supply the European Community demand for aircraft; consequently, it would be counter productive for the EC to discriminate against non-EC producers.

U.S. investment and operating conditions in the EC.—Currently, there are two important joint ventures between U.S. aircraft engine manufacturers and EC counterparts. However, EC companies have increasingly sought capital and risk-sharing status with companies in Indonesia, Brazil, the People's Republic of China, and Japan to produce aircraft and low-powered aircraft turbine engines. Increasingly, as U.S. aircraft engine manufacturers increase their world market share, thereby distancing themselves in the market from the remaining large EC engine manufacturer, Rolls-Royce, plc., and the costs of bringing a new engine to market rise to between $1–2 billion, joint ventures and/or risk-sharing status are becoming increasingly attractive. It is unclear whether either of the two large U.S. companies would seek EC partners; rather, it would be more likely that the EC companies would seek U.S. partners and capital. Working arrangements between U.S. and EC firms are likely to become more commonplace in future jet-engine development, though outright mergers do not seem to be likely, given national security concerns.

U.S. industry response.—The U.S. aerospace industry is reportedly adopting a cautious attitude with regard to this regulation, as U.S. investment is minimal in the EC. Also, the EC historically has been a net consumer of U.S. aerospace products, and this situation is not likely to change in the foreseeable future, due in some part to capacity and capital constraints in EC.

Views of interested parties.—No formal submissions were received.

Grains and oilseeds

Possible effects.—

U.S. exports to the EC.—U.S. exports of grains and oilseeds to the European Community will probably not be significantly affected by this Merger Regulation. The Merger Regulation may have small trade-discriminatory effects from the point of view of U.S. exporters that wish to secure market access by acquiring or merging with EC grain or oilseed processors. However, although such acquisitions of EC operations by U.S. grain/oilseed exporters were common in the past, they have leveled off in recent years. U.S. grain and oilseed farmers have an economic interest in maintaining a strong processor demand for their farm products (mostly corn, soybeans and sunflower seed) and in preventing monopsony power—whether in the United States or in the European Community.

Several of the large U.S. grain and oilseed exporters (such as Cargill, Continental Grain, and Archer Daniels Midland) operate grain- or oilseed-processing facilities in the EC, some of which were acquired rather than built by the present owners (hence, their acquisitions would have been affected by the Merger Regulation had it been in place in earlier years). The oilseed-processing industry and, to a lesser extent, the grain-processing industry, in the EC consist predominantly of subsidiaries of U.S.-based multinationals. These processing facilities are supplied by domestic EC grain/oilseed production as well as exports from the United States and third countries, although the EC subsidizes oilseed processors that use EC-grown oilseeds but does not subsidize the processing of imported oilseeds.

U.S. exports could be adversely affected if the Merger Regulation proves to be restrictive. Because U.S. exports to the EC are frequently related-firm transactions, any restrictions on growth of the EC operating firm or the establishment of an operation by a U.S. company in the EC could affect U.S. grain/oilseed export levels.

U.S. exports of grains and oilseeds totaled $11.7 billion in 1988, most of which ($9.8 billion, or 84 percent) consisted of corn and soybeans. Japan is the largest single market for U.S. exports of corn, taking $3.2 billion in such exports (30 percent of total exports) in 1988. The largest

market for U.S. exports of soybeans is the EC, which took about $2 billion (40 percent of total exports) in 1988; the second-largest market is Japan, which took almost $1 billion in 1988. U.S. grain and oilseed exports to the EC totaled $2.5 billion in 1988, or about 20 percent of total U.S. exports.

Diversion of trade to the U.S. market.—The Merger Regulation will not significantly reduce EC demand for, or domestic supply of, grains and oilseeds. Consequently, EC imports of grains and oilseeds from third countries will not be significantly changed, nor will such third-country exports be diverted to the U.S. market.

U.S. investment and operating conditions in the EC.—The immediate effect of the EC Merger Regulation will be small on investment or operating conditions among processors in the EC. Economic conditions at this time discourage investment in the industry, and the wave of mergers and divestitures of existing processors observed in the early and mid-1980s has apparently abated.

However, the Merger Regulation is likely to adversely affect long-term future U.S. investment and operating conditions in the European Community. Such investment is dependent upon expectations of growth in EC market demand, and the likely availability of EC subsidies to processors of EC grains and oilseeds. Both rapid market growth and the subsidy incentive have induced U.S. firms to invest in the EC market in past years. U.S. industry sources report that soft EC markets have recently slowed the pace of such investment, that the market softness is probably a temporary business-cycle phenomenon, and that future recovery of these markets may cause U.S. firms to consider further market expansion. Future trends in EC-financed processor subsidies are much less certain, and cannot be assessed here.

A handful of U.S. firms currently make up much of the EC industry. In oilseeds, U.S. trade association sources report a 60- to 70-percent market share held by the top three U.S.-owned firms. In corn and other grains, the U.S. share is not quite as large but still substantial. These market shares were achieved mainly through acquisitions by large U.S. firms of medium or large EC processing facilities. Because the acquiring firms were usually large, similar mergers in the future are quite likely to fall within the scope of the Merger Regulation. Because of the current size of U.S. investment in the EC market, industry sources indicate that the EC Commission may curb future U.S. expansion in that industry. (Likewise, if the EC market weakens, the Merger Regulation may also hinder exit from the EC industry because U.S. firms may not be able to find buyers for unprofitable facilities if the EC determines that likely buyers (e.g., the EC-based Unilever or Dreyfus firms) would be too large.)

U.S. industry response.—There is likely to be no response to this regulation. The U.S. industry has not indicated that it has a concern with the Merger Regulation on antitrust.

A leading trade organization indicated that this antitrust/merger regulation was not considered to be a threat to U.S. interests. A representative of the leading oilseed trade association indicated he did not believe that there would be any short-term effect since there is little likelihood of further mergers among oilseed-processing firms. A representative of another trade group indicated there may be a long-run resumption in merger activity (if profitability improves), which may be adversely affected by the Merger Regulation.

Views of interested parties.—No formal submissions were received.

Financial services

Possible effects.—

U.S. exports to the EC.—As U.S. financial institutions provide a service, commodity exports in the traditional sense do not exist. Though financial activities may originate in the United States, financial services by U.S.-based firms generally appear to be provided through branches or subsidiaries established in the EC. Literature generated by the industry included no information with which to accurately quantify the amount of fees or revenues generated by U.S.-based financial firms operating in the EC from the United States or in the EC directly. Additionally, private industry, government, or trade association representatives contacted had no available information upon which to provide reliable data.

Insurance.—Insurance industry sources indicate that although many large U.S. insurers are generally aware of the EC92 initiative, little formal analysis has yet been done concerning this Merger Regulation. Two specialist EC-based legal firms (London and Paris) were somewhat more knowledgeable but stated that it will not be possible to definitively interpret the Merger Regulation until additional political decisions are made by EC officials.

Financial services.[87]—The prospect of increased competition in the financial services sector resulting from deregulation[88] will enable—and should encourage—U.S. investment banks to broaden their client base across national

[87] The financial sector is the subject of extensive regulation. Whereas this section addresses only the impact of the Merger Regulation, ch. 6, on the financial sector, looks at those directives addressing the financial services sector as a whole.

[88] See ch. 5, "Financial Sector," for a comprehensive discussion of deregulation in the financial services sector.

borders in the European Community, as well as offer expanded services to those clients. Because most of the expansion of U.S. investment banking firms within the European Community has been through growth rather than through mergers and acquisitions of other EC firms, senior management within these institutions, so far, has been more concerned with assessing the impact of the proposed regulation on their clients rather than on their own operations. However, officials speculate that unless the aggregate worldwide turnover of all undertakings[89] is raised, the proposed regulation may have a definite negative impact on the operations of the larger investment banks should they choose to expand with the European Community via the mergers and acquisitions route.

Because a number of U.S. investment banks in the EC are heavily involved in the financing of these merger and acquisition activities on behalf of their clients, with revenue from these activities reaching 80 percent of gross revenues for some of these firms, the progress of this Merger Regulation is being viewed with great interest by these firms. The merger and acquisition activity that has characterized the U.S. market during the last 5 years has also spread to the member states of the European Community. U.S. investment banking firms operating in the EC have also greatly benefited as a result of the prospect of EC92 implementation as both EC and non-EC firms have expanded throughout the EC, often through mergers and acquisitions, in an effort to establish a market position before markets are finally deregulated in 1992.

Two large U.S. investment banks with operations in the EC state that they would like to see the proposed 1,000 million ECU threshold of aggregate worldwide turnover of all undertakings concerned raised, so that larger mergers could proceed without prior control by the EC Commission. However, even if the threshold remains at the current proposed level, firms could avoid merger control by the EC Commission by engaging in mergers and acquisitions that do not result in concentrations having a Community dimension; that is, concentrations in which the aggregate worldwide turnover of all the undertakings concerned is less than 1,000 million ECU or, the aggregate EC turnover of the undertakings is less the 100 million ECU. According to these sources, larger mergers (those concentrations defined as having a "Community dimension") account for only a very small percentage of total merger and acquisition revenue earned among these firms.

One aspect of the Merger Regulation that could prove to be trade liberalizing for investment banking firms is the coordination and standardization of existing regulations. At present, Greece, Denmark, and Italy have no national takeover rules because takeovers rarely occur there. Belgium and Luxembourg take a case-by-case approach to public takeovers, whereas France, West Germany, and the United Kingdom have a statutory legal framework. Still other EC nations rely on certain "codes of conduct" with various degrees of legal enforcement. Investment banking officials feel that if the EC adopts a single legal standard it would help firms to be certain of their legal position throughout the EC and may actually encourage more merger and acquisition activity.

Diversion of trade to the U.S. market.—Diversion of trade to the U.S. market from the European Community is not expected as a result of the Merger Regulation for either the insurance or financial services industries. Takeover offers in the U.S. market have more to do with U.S. takeover laws and the economic viability of the proposed merger or acquisition than with what the EC proposes to do concerning antitrust matters.

U.S. investment and operating conditions in the EC.—Conversations with officials at U.S. investment banking firms in the EC indicate that the Merger Regulation is expected to have little effect on the ability of these firms to expand within the European Community unless they choose to expand their operations through mergers and acquisitions rather than through the opening of new branches or subsidiaries, as they have done in the past. The effect of the Merger Regulation on the merger and acquisition activity of these firms undertaken on behalf of their clients is expected to fall unevenly, with those firms specializing in larger mergers and acquisitions being impacted more severely than those firms that specialize in smaller takeovers. Investment banking officials state that unless the 1,000 million ECU limit is periodically raised, the Merger Regulation would eventually limit the growth potential of all firms in the industry.

By consolidating and coordinating EC merger and acquisition policy, the Merger Regulation is expected to benefit U.S. investment banking firms, which will then be able to operate within EC nations under a clear and consistent set of guidelines and standards.

U.S. industry response.—According to industry sources, the Merger Regulation, if enacted, is likely to encourage financial services firms to concentrate more of their merger and acquisition activities on those smaller takeovers that fall below the thresholds. This will serve to neutralize some of the adverse effects that may result from enactment of the Merger Regulation.

Unless the thresholds are periodically raised, U.S. firms may choose to slow the growth of U.S.

[89] Conversations with industry representatives were conducted before the upper threshold was raised from 1,000 million to 2,000 million ECU.

subsidiaries or partnerships established throughout the EC to handle merger and acquisition activity. However, one benefit working to encourage investment bank expansion will be the consolidation and coordination of various EC Merger Regulations governing merger and acquisition activities that are embodied in the Merger Regulation.

U.S. financial services firms in the EC generally support those features of the Merger Regulation that seek to coordinate and consolidate various EC Merger Regulations governing merger and acquisition activities. However, they are somewhat concerned over whether the EC will adopt a threshold limit on the size of takeovers that would discourage such activity.

Views of interested parties.—No formal submissions were received.

Directive 88/301 Directive on Competition in the Markets for Telecommunications in Terminal Equipment

Background

The national post, telegraph and telecommunications companies (PTTs) hold a virtual monopoly in the telecommunications end-user terminal equipment[90] area through exclusive service contracts and exclusive supply contracts and by granting exclusive production contracts, usually awarded to national manufacturers. These monopolies violate many articles of the Treaty of Rome, including article 30, which prohibits quantitative restrictions, and article 86, which prohibits the abuse of a dominant position.[91]

In the Green Paper on telecommunications issued in 1987,[92] the EC Commission emphasized the need for greater competition in the telecommunications area. The EC Commission noted that with the proliferation of terminal equipment, users should be given the opportunity to take advantage of the greater availability of products. Furthermore, advances in telecommunications equipment have made it a globalized sector and one with great growth potential. The Green Paper emphasized the need to open the market for end-user terminal equipment as a major condition for the achievement of the internal market by 1992 and "to react to technological, economic and world trends."[93] Despite the favorable reception of the Green Paper by the member states and the consensus that the telecommunications market must be opened, extensive action has yet to be taken on the action proposed.[94]

On May 16, 1988, the EC Commission passed this directive establishing guidelines for creating competition in the telecommunications end-user terminal equipment.[95] In passing the Telecommunications Directive, the EC Commission relied on article 90(3) of the Treaty of Rome, which empowers it to issue "appropriate directives" to monitor relations between the member states and those public enterprises that enjoy special rights, especially quantitative restrictions and other measures that violate the treaty. The EC Commission considered the exclusive right of the PTTs to import, supply, and sell terminal equipment an infraction of the treaty and utilized its power under article 90 of the Treaty of Rome to end the violation.[96]

Using article 90, the EC Commission was able to bypass a Council vote normally required to bring a directive into force. The substantive provisions of the Telecommunications Directive are not the subject of debate; member states realize that the current monopolies held by most of the PTTs will not be able to survive.[97] They did, however, strongly resent the procedural manner in which the EC Commission circumvented the Council.[98] Consequently, the French, Belgian, Italian, and Greek Governments challenged the EC Commission's action in the European Court of Justice, alleging that the directive is illegal. A decision will probably come down in June.[99]

Anticipated Changes[100]

The changes required to implement this directive will focus mainly on the elimination of

[90] There are three main areas of telecommunications terminal equipment: 1) central office switching equipment, (2) customer premise equipment (e.g., telephone, facsimile machines, and private business exchanges), and (3) transmission equipment (e.g., modums and wiring). For the most part, it is with the customer premise equipment that this directive is most concerned.
[91] USITC staff meeting with a member of DG IV, Apr. 18, 1989.
[92] *Toward a Dynamic European Economy, Green Paper on the Development of the Common Market for Telecommunications Services and Equipment*, COM(87) 290 final (June 30, 1987) [hereinafter the "Green Paper"].
[93] Green Paper, p. 12.
[94] USITC staff meetings with a member of IBM France, Apr. 25, 1989, and with a member of IBM Germany, Apr. 28, 1989.
[95] See footnote 4, above.
[96] USITC staff meetings with a member of DG IV, Apr. 18, 1989, and with a member of the International Telecommunications Branch, DTI, Apr. 21, 1989.
[97] Conversation with Auke Haagsma, First Secretary, Legal Affairs, Delegation of the Commission of the European Communities, Mar. 16, 1989[hereinafter "Haagsma Conversation"].
[98] USITC staff meeting with a member of DG IV, Apr. 18, 1989.
[99] Ibid.
[100] This section, which discusses the changes that will occur as a result of this directive, presupposes that the European Court of Justice will uphold the action of the EC Commission.

the monopoly held by national PTTs and the separation of the regulatory and commercial functions of the PTTs.[101]

Specifically, member states must remove all monopolies granted by them to any undertakings in the provision of terminal equipment.[102] Quantitative restrictions on the import of terminal equipment will be removed, along with restrictions on marketing, servicing, and maintaining such equipment.[103] Although there is currently some competition in the telecommunications equipment market, the largest problem is the "first telephone" rule. The PTTs will no longer be permitted to require that consumers purchase the first telephone from the PTT.[104]

In addition, member states must change their law to allow customers to terminate long-term service or lease contracts in order to enjoy access to the newly available products.[105]

To ensure access to the markets, article 5 requires that member states transmit to the EC Commission a list of all technical specifications and type-approval procedures for terminal equipment.[106] These specifications will then be published. The purpose is to make the procurement procedure for terminal equipment transparent in order that anyone may compete. Telecommunications officials interviewed by USITC staff indicated that the process is currently far from transparent, and moreover, is long and cumbersome.[107]

Although the directive ends the PTTs' monopoly powers, they retain the power to protect the network, thereby retaining the power to set quality standards.[108] The Europeans are extremely wary of "cheap" phones from the Pacific Rim countries and are fearful that if plugged in, these phones would damage the network.[109] The fear has been expressed that this approval process may become a restraint on potential suppliers.[110] However, the same official who voiced this fear later admitted that it is difficult to use technical specifications to keep suppliers out of the market.[111] Officials from the EC Commission assured the USITC staff that the EC Commission will exercise oversight authority to ensure that the PTTs do not abuse the power to establish technical specifications.[112]

The other major change instituted by this directive is the requirement that member states separate the regulatory and commercial roles of the PTTs.[113] Hereafter, all regulatory activity is to be carried out by a body independent of any undertaking in the telecommunications industry. Some member states have already separated these activities, and others are taking steps in that direction.[114]

Many member states, although they recognize the inevitability of the opening of the telecommunications market, still have not opened their markets.[115] Furthermore, even if the Court upholds the EC Commission's action, member states must change their laws to implement the directive, and once the laws are in place, further delay may result from any judicial interpretations of the law. Thus, the market opening that is supposed to result from this directive may still be in the distant future.

Possible Effects

U.S. exports to the EC

The implementation of the Telecommunications Directive is likely to open the EC market to non-EC suppliers. U.S. industry sources view this directive as an opportunity to compete in a market that otherwise has been closed to non-EC countries. Currently, the telecommunications networks in the member states are operated by PTTs, which direct their procurement of terminal equipment to local suppliers. In addition, an open EC market is expected to be facilitated by the adoption of a common transmission standard for telephone and telegraph apparatus. Third-

[101] USITC staff meeting with members of Government Relations Department, British Telecom, Apr. 21, 1989.
[102] Telecommunications Directive, art. 2.
[103] Telecommunications Directive, art. 3.
[104] USITC staff meetings with a member of DG IV, Apr. 18, 1989; and with members of IBM Germany, Apr. 28, 1989.
[105] Telecommunications Directive, art. 7.
[106] USITC staff meeting with a member of DG IV, Apr. 18, 1989. This directive is only one in a process to fully open the European telecommunications market. The EC Commission hopes to develop European standards for telecommunications equipment and to have products inspected and approved in one member state automatically accepted in other member states. See Green Paper, p. 5.
[107] USITC staff meetings with a member of AT&T (UK) Ltd., Apr. 21, 1989, and with members of IBM Germany, Apr. 28, 1989.
[108] Telecommunications Directive, art. 3; Green Paper, p. 12.
[109] Liberalization in the United States is not viewed in Europe as having been successful because of the profusion of these cheap phones from the Pacific Rim. USITC staff meeting with members of the Office of Information Technology and Telecommunications Policy, German Ministry of Economics, Apr. 28, 1989.
[110] USITC staff meeting with members of the International Telecommunications Branch, DTI, Apr. 21, 1989.
[111] Ibid. The Japanese have expressed little concern about standards, claiming that they can adjust to standards. USITC staff meetings with a member of Fujitsu Ltd. on May 19, 1989; with a member of Marubeni, May 10, 1989; and with a member of Sony, May 11, 1989.
[112] USITC staff meeting with a member of DG IV, Apr. 18, 1989.
[113] Telecommunications Directive, art. 7.
[114] USITC staff meetings with members of Mercury Communications, Apr. 21, 1989; with members of Government Relations Department, British Telecom, Apr. 21, 1989; and with members of the Government Relations Department, IBM Germany, Apr. 28, 1989.
[115] USITC staff meeting with a member of DG IV, Apr. 18, 1989; telephone conversation with a member of the American Petroleum Group, May 8, 1989.

country suppliers would prefer a common standard rather than the 12 different standards that currently exist in the EC. The EC Commission has been highly receptive to permitting U.S. participation in the development of the telecommunications standards that are being contemplated. In the future, the EC Commission is expected to release a directive covering equipment testing and certification, which also should add transparency to the procurement process.

The Telecommunications Directive may apply to bids from firms established both within and outside of the member states. The Telecommunications Directive permits subsidiaries or agents of a non-European firm to participate in procurement activities provided that they are established within a member state. Currently, no precise definition of the term "established" has been incorporated into the directive. Nonetheless, a narrow definition might lead to the exclusion of suppliers operating outside of the EC.

The EC remains the largest export market for the United States in telephone and telegraph equipment, followed by Canada and Japan. The total value of U.S. exports to the European Community increased steadily from $818 million in 1984 to $1.3 billion in 1988, or by 64 percent. The large increase in exports to the EC, particularly in 1988, was due, in part, to the weaker dollar, which has enhanced the price competitiveness of U.S. products. The potential exists for U.S. exports to the EC to continue to increase during the next 5 years.

The only other significant export market for the U.S. industry is Canada, whose 12-percent share of U.S. exports made it the largest single-country market in 1988, followed by Japan, with 9 percent. Exports to Canada, after declining considerably in 1985, recovered in 1986 and continued to expand through 1988, when they totaled $751 million, representing a 45-percent increase over the 1984 level.

Diversion of trade to the U.S. market

The Telecommunications Directive is not likely to be trade discriminatory against the United States or other third-country suppliers. The terminal equipment market in the EC should show significant growth following deregulation and provide increased opportunities for third-country suppliers as well as those in the EC. The U.S. market in terminal equipment has been deregulated since 1984 and is currently very price competitive. With the EC market more likely to open than close, and with the current condition of the US market, it is unlikely that much trade diversion will result from the implementation of this Directive, and what little diversion is created will have no significant impact on the U.S. market.

Overall, U.S. imports of Japanese telephone and telegraph equipment increased from 1984 to 1988, rising from $8.7 billion in 1984 to $9.8 billion in 1988, or by 12 percent. Within that period, however, there were fluctuations in the market, with U.S. imports from Japan increasing from $11.1 billion in 1985 to $12.2 billion in 1986, but decreasing to $10.2 billion in 1987. Nonetheless, Japan remained the largest supplier by far, although its share of the total value of imports decreased from 56 percent in 1984 to 46 percent in 1988. The extent of any diversion of Japan's EC-bound trade to the United States would most likely be modest.

The U.S. industry dominates the U.S. market for telephone and telegraph equipment in the commercial and business sector. U.S. producer shipments rose at an annual rate of 3 percent during 1984–88, increasing from $14.2 billion in 1984 to $16.3 billion in 1988. However, a number of producers are producing offshore to remain cost competitive in the marketplace. The consumer sector of the U.S. market is dominated by imports from Japan, South Korea, Singapore, and Mexico.

Total Standard International Trade Classification (SITC) imports of telephone and telegraph equipment during 1984–88 rose to a high of $21 billion. Aside from Japan, the only significant suppliers were Canada and the United Kingdom, both supplying approximately 3 percent of imports in 1988.

U.S. investment and operating conditions in the EC

U.S. investment in telephone and telegraph equipment production in the EC would most likely be adversely affected by this directive. U.S. OEMs of this equipment will be affected by the directive's implementation because of the structural changes needed in the equipment to comply with the EC standard.

Domestic-content requirements would most adversely affect third-country suppliers. Purchasing authorities, particularly those under direct government control, are likely to come under strong pressure to apply such requirements.

U.S. Industry Response

AT&T, which is the largest U.S. manufacturer of telephone and telegraph equipment, has taken steps toward penetrating the EC market during the past 5 years. AT&T's approach to penetrating the EC market has been to make direct investments in the European market through joint-venture agreements. Direct investments have been made with two Italian firms as well as with a semiconductor facility in Madrid, Spain. AT&T and other U.S. suppliers are also awaiting clarification on numerous issues addressed in the

EC Commission's directives. Specifically, these issues of concern include clearer definitions on technical standards, local content, reciprocity, and bidding procedures.

U.S. exports of telecommunications products under SITC chapter 76 in 1988 were as shown in the following tabulation (in millions of dollars):

Market	U.S. exports
EC	1,345
Japan	583
Canada	751

Exports from the United States to the EC represent 21 percent of all such telecommunications exports from the United States.

Views of Interested Parties

No formal submissions were received.

Regulation 2137/85 The European Economic Interest Grouping

Background

The catalyst for the creation of this new legal entity called the European Economic Interest Grouping was the desire of the EC Commission to increase and facilitate intra-European cooperation. Many European companies at present are too small and their efforts too concentrated on national markets to reap the benefits of the economies of scale that will be provided by the greater economic integration after 1992, or to compete on the world market.[116] The EC Commission, to encourage the "harmonious development of economic activities and a continuous and balanced expansion throughout the Community,"[117] and failing to pass a European Company Statute,[118] created a new legal structure, the EEIG.

The EEIG is modeled after the French *Groupement d'interet Economique*[119] of which Airbus Industrie is the most notable example. The treaty authority for the EEIG is article 235, allowing the EC Commission to enact appropriate measures to fulfill needs of the EC not covered by the treaty.

Reaction to the EEIG has been mixed. Officials responsible for company law in the Directorate General of the EC Commission reported that a conference on the EEIG held in Brussels in March 1989 had an overwhelming response; officials from the German Ministry of Economics similarly have received numerous inquiries but admit that the EEIG may not enjoy the popularity its prototype had in France.[120] However, some company law experts in France, the United Kingdom, and West Germany have given the EEIG a lukewarm reception, with the caveat that it does not solve the major problem of taxation by member states of the companies involved.[121]

Anticipated Changes

This regulation creates the first legal structure for cross-border cooperation of companies in different member states. An entirely new legal format, the EEIG has attributes found in both partnerships and joint ventures. An EEIG is a legal entity recognized throughout the entire European Community following registration in a single member state.[122] In order to form an EEIG, the regulation requires only two formalities: (1) a written contract establishing those details of the relationship not set out in the EEIG Regulation,[123] and (2) registration of the EEIG in a member state.[124] Members of an EEIG may be either companies or individuals, but they must have a presence in the EC and at least two must be from different member states.[125] The regulation requires that the EEIG have at least two organs: (1) one or more managers and (2) the members acting collectively.[126] The manager(s), acting on behalf of the EEIG, can bind the EEIG in contracts with third parties, even if those acts go beyond the objectives of the EEIG.[127]

The EEIG Regulation states that the members have unlimited joint and several liability for all debts of the EEIG but leaves the consequences of such liability to the determination of the member states.[128] A creditor may not proceed against the individual members unless the debt is actually one of the EEIG, and not until the liquidation of the EEIG is complete, unless a request for payment had been made and ignored.[129]

[116] Haagsma Conversation; see also Weiss, Friedl, "The European Economic Interest Grouping"(available at U.S.International Trade Commission Law Library) [hereinafter "Weiss"].
[117] EEIG Regulation, preamble.
[118] See *Proposed Regulation for a European Company Statute, O.J.* No. C 124, (Oct. 10, 1970). But see Financial Times, July 13, 1989, p. 1, col. 4 (EC Commission tables a proposal for a European Company Statute).
[119] See French Ordinance No. 67-821 of Sept. 23, 1967; French Decree No. 68-109 of Feb. 2, 1968.
[120] USITC staff meeting with members of the German Ministry of Justice, Apr. 27, 1989.
[121] USITC staff meetings with members of Companies Division, DTI, Apr. 20, 1989; with members of the German Ministry of Justice, Apr. 27, 1989; and with a member of the Office for Company Law, Deutschen Industrie und Handelstag (German Association of Trade and Industry)[hereinafter DIHT], Apr. 27, 1989.
[122] EEIG Regulation, art. 1(2).
[123] See EEIG Regulation, art. 5.
[124] EEIG Regulation, art. 1(1).
[125] EEIG Regulation, art. 4(1) and (2).
[126] EEIG Regulation, art. 16(1).
[127] EEIG Regulation, art. 20.
[128] EEIG Regulation, art. 24; see also, Weiss, p. 10.
[129] EEIG Regulation, art. 24(2).

The EEIG Regulation states that the purpose of the EEIG is to "facilitate and develop the economic activities of its members and to improve or increase the results of those activities."[130] In encouraging this end, however, the regulation establishes certain limits on the activities of the EEIG. An EEIG may not dominate or direct the central functions of its members,[131] it may not have more than 500 employees (to avoid the German worker participation requirements),[132] and it may not accrue any profits.[133] Furthermore, primarily for tax and liability reasons, an EEIG may not be a member of another EEIG.[134]

One of the advantages of the EEIG is its flexibility. The regulation requires only that the contract be in writing and include minimum requirements, leaving many of the details of the organization and functions of the EEIG to be determined by the members. Furthermore, allowing different legal persons to be members seems a further indication of the EC Commission's desire to create a flexible structure.[135]

Possible Effects

The EEIG Regulation will allow companies to pool resources and skills in a variety of activities, from combined accounting activities to combined sales promotion and even secondary manufacturing activities such as packaging.[136] This pooling of resources and skills could provide cost benefits to companies participating in the EEIG. In addition, companies that might be too small to undertake research and development projects on their own will have a new legal form through which they can undertake joint projects. This opportunity could help EC companies, especially small and medium-sized firms, enhance or at least maintain their competitiveness. It is not certain whether U.S. individuals or companies will be allowed to be members of an EEIG. If U.S. companies are not able to participate, this regulation could provide EC companies with benefits not available to U.S. companies. However, if only European individuals or companies are allowed to participate in an EEIG, U.S. companies will only need to establish a "brass plate" subsidiary in a member state to meet that requirement.[137] U.S. exporters could be adversely affected if EEIGs enhance the competitiveness of products produced in the European Community. The major question at this point seems to be whether firms in the EC will find "sharing" adequately profitable to their firms to justify the formation of an EEIG. The Airbus consortium and some law firms reportedly are already planning for conversions to the EEIG legal format. However, if legal associations in the member states allowed the establishment of partnerships and accepted the qualification standards in all member states, EEIGs of law firms would be unnecessary.

The EEIG falls short of a "European" company based entirely on EC law because the regulation refers to national law in such areas as contract formation, taxation, liability, and liquidation.[138] Nevertheless, "there is a pre-eminence of Community objectives over national ones,"[139] giving the EC its first, but perhaps not last, experience with intra-European businesses. The EEIGs, if a success, may serve as impetus for action on the European Company Statute.

Views of Interested Parties

No formal submissions were received.

Company Law Directives COM(83) 185; COM(84) 727; COM(88) 153

General Background

The harmonization of company law has been a longstanding goal of the European Community.[140] Harmonization will facilitate cross-border business activity and will contribute to the attainment of the single internal market by equalizing the business environment in all member states. Starting shortly after the signing of the Treaty of Rome, which created the EEC, the EC Commission proposed a number of company law directives, some of which the Council has passed, in an effort to coordinate company law

[130] EEIG Regulation, art. 3(1).
[131] EEIG Regulation, art. 3(2)(a).
[132] EEIG Regulation, art. 3(2)(c). A Brussels attorney, formerly with the EC Commission, pointed out that although the regulation limits the EEIG to 500 employees, there is no prohibition against detailing employees from the parent companies. USITC staff meeting with an attorney in Belgium, Apr. 17, 1989.
[133] EEIG Regulation, art. 3(1); see also, EEIG Regulation, art. 21(1).
[134] EEIG Regulation, art. 3(2)(e); Haagsma Conversation.
[135] USITC staff meeting with an attorney in Belgium, Apr. 17, 1989.
[136] Some of the proposed EEIGs mentioned at the EEIG Information Day in Brussels include an association of lawyers, an organization to train business managers, an association to develop a European transport network, a project to promote the export of European handicrafts, and a group to develop and promote software.
[137] USITC staff meeting with members of the Companies Division, DTI, Apr. 20, 1989.
[138] See generally Woodbridge, Frank, "The Draft Regulation on the European Economic Interest Grouping," *The Journal of Business Law*, (January 1985), p. 73.
[139] Weiss, p. 10.
[140] Verloop, Peter, "The New Company Law Statute and Harmonization of Business Law Among Member States," (Paper presented at the ABA Conference "1992: New Opportunities for U.S. Banks and Businesses in Europe," Feb. 23 and 24, 1989, New York), p. 109.

among the member states.[141] Three of the directives addressed herein, on the structure of public limited companies (Fifth Directive),[142] on cross-border mergers (Tenth Directive),[143] and concerning disclosure requirements of branches (Eleventh Directive)[144] are still in the proposal stage. In the April 13 meeting of the Internal Market Council, the ministers came to a "common position" on the Eleventh Directive, nearly assuring its passage in its current form.[145]

Fifth Directive

The Fifth Directive is based on article 54(3)(g) of the Treaty of Rome, empowering the EC Commission to establish throughout the EC equivalent safeguards required of companies and firms. Such coordination is difficult when business philosophies and practices differ as much as they do in Europe. One EC official opined that labor relations tend to play a greater role in company management in the European Community than they do in the United States, and even within the European Community their importance varies.[146] In the United Kingdom and, to a lesser degree, in the Netherlands, a company is considered the property of the shareholders with the profit motive being the driving force. In other member states, much more emphasis is given to labor relations; the company does not exist solely to create profit for its shareholders but must consider the rights of its employees in making business decisions.[147] Worker participation schemes in Europe run the gamut from no employee participation in the Netherlands, which uses co-option to fill vacancies on the supervisory board,[148] to West Germany, which requires employee representatives on the board.[149] The Fifth Directive was first proposed in 1972[150] to protect both shareholders and employees, but has failed to win approval, mostly due to the controversial worker participation provision.

Tenth Directive

As with the Fifth Directive, the Tenth Company Law Directive is based on article 54(3)(g) of the Treaty of Rome, which directs the EC Commission and the Council to coordinate company law. Currently, cross-border mergers are prohibited under national law in almost all member states. With the opening of the single internal market in 1993 and the need for larger economies of scale, the EC Commission recognized the need to ease transborder mergers. The Tenth Directive was proposed to facilitate and thereby encourage mergers to create European companies that could compete in world markets.[151]

Eleventh Directive

The Eleventh Directive sets disclosure requirements for branches of companies registered in other than the host country. Article 52 of the treaty directs member states to abolish restrictions on establishment within their territory by a national of another member state. In order to facilitate the exercise of the freedom of establishment, the EC Commission and Council have passed a number of Directives coordinating accounting requirements for companies,[152] but these requirements applied only to the companies and not to their branches. Although branches and subsidiaries sometimes carry out similar activities, parties dealing with subsidiaries are ensured of an equivalent level of protection throughout the EC; those dealing with branches are protected only under national law, if at all. The EC Commission introduced this Directive in the belief that this disparity of treatment interfered with the exercise of the right of establishment.

Anticipated Changes

Fifth Directive

Two features of the Fifth Directive will strongly alter company structure if the Directive is

[141] The Company Law Directives that have been passed by the Council are as follows:
First Council Directive 68/151, *O.J.* No. L 65/8, (Mar. 14, 1968)(disclosure requirements of limited liability companies);
Second Council Directive 77/91, *O.J.* No. L 26/1, (Jan. 31, 1977)(the formation and capital of public limited companies);
Third Council Directive 78/885, *O.J.* No. L 295/36, (Oct. 20, 1978)(merger of public limited companies);
Fourth Council Directive 78/660, *O.J.* No. L 222/111, (Aug. 14, 1978) (coordination of company accounting requirements);
Seventh Council Directive 83/349, *O.J.* No. L 193/1, (July 18, 1983) (coordination of consolidation of accounts of some limited liability companies); and
Eighth Council Directive 84/253, *O.J.* No. L 126/20, (Dec. 5, 1985) (professional qualifications of auditors).

[142] *Amended proposal for a Fifth Directive founded on article 54(3)(g) of the EEC Treaty concerning the structure of public limited companies and the power and obligations their organs*, COM(83) 185, *O.J.* No. C240/3, (Sept. 9, 1983)[hereinafter "Fifth Directive"].

[143] *Proposal for a Tenth Council Law Directive based on article 54(3)(g) of the Treaty concerning cross border mergers of public limited companies*, COM(84) 727 (final), *O.J.* No. C23/11, (Jan. 25, 1989)[hereinafter "Tenth Directive"].

[144] *Amended Proposal for an Eleventh Council Directive on company law concerning disclosure requirements in respect of branches opened in a Member State by certain types of companies governed by the law of another State*, COM(88) 153 (final) *O.J.* No. C105/6, Apr. 21, 1988 [hereinafter "Eleventh Directive"].

[145] *Council of the EC Press Release* 5829/89; see also *1992: The External impact of European Unification*, (Buraff Publications (Apr. 21, 1989)) p. 4.

[146] Haagsma Conversation.

[147] Ibid.

[148] Under the co-option system, the remaining members of the board (either supervisory or managerial) appoint a person to fill a vacancy.

[149] See generally "Doing Business in Europe," *Common Market Reporter* (CCH).

[150] *O.J.* No. C 7 (Jan. 28, 1972).

[151] European Economic Community Press Release, January 1988.

[152] See footnote 141, above.

passed. The first allows a member state to require that all companies have a two-tiered management structure, providing a separate supervisory board and management board.[153] Though expressing a clear preference for the two-tiered structure, the Directive allows for a single-tiered board structure if the administrative board's functions are clearly divided into supervisory activities and managing activities.[154] In a company with a dualist board structure,[155] article 3 requires that the day-to-day functions of the company be managed by a management board appointed and supervised by the supervisory board. The proposal sets forth extensive rules regarding such matters as eligibility for management and supervisory boards,[156] duration of appointments,[157] allocation of management authority,[158] acting for the company,[159] salaries,[160] and dismissal.[161] The Directive further establishes rules on the procedures for an annual general meeting[162] and for the adoption and auditing of annual accounts.[163]

The second, and more controversial, aspect of the directive is the worker participation provisions. Article 4(2) requires that member states provide for some form of worker participation in companies employing more than 1,000 workers. The Directive offers four alternative approaches: (1) worker participation on the supervisory board, wherein the employee representatives compose 30 to 50 percent of the board,[164] (2) employee participation on the supervisory board through co-option[165] (3) creation of a workers' council,[166] or (4) a choice of one of the three above-described approaches determined through collective bargaining.[167]

The controversy surrounding the Fifth Directive focuses primarily on the worker participation issue.[168] The Germans, with the apparent support of the EC Commission, are adamant about wanting to extend their worker rights to the rest of the European Community,[169] whereas the British just as strongly refuse to accept mandatory worker participation, preferring to leave such arrangements up to negotiation between management and labor.[170]

The majority of individuals (both government officials and private attorneys) with whom USITC staff spoke recognized that the Fifth Directive will pass eventually with some form of worker participation.[171] The most likely compromise will be an "entry level" (i.e., minimum) requirement of some form of worker participation perhaps negotiated between management and labor.[172] The EC Commission would thereafter conduct periodic reviews with the intent of increasing the level of worker participation to the level of the German system.[173]

Tenth Directive

The most important change that will result if the Tenth Directive is passed will be the ability of companies in two different member states to merge.[174] On the one hand, the broadening of the scope of possible merger targets could significantly change the rules of the game for mergers and acquisitions in Europe; but on the other hand, with some exceptions, because the technical rules established by the Directive are merely those in the Third Company Law Directive[175] transposed onto cross-border mergers, the procedural aspects of how a merger is accomplished will probably not change significantly.

The reason for the delay in passing the Tenth Directive is the European Parliament's hesitation to allow cross-border mergers without action on the Fifth Directive providing for the protection of workers.[176] The Parliament (and the German unions) fear that companies will merge away from countries with employee participation, depriving the workers of their rights.[177] If progress is made

[153] Fifth Directive, art. 2(1).
[154] USITC staff meeting with a member of DG XV (Company Law), Apr. 19, 1989.
[155] This discussion will focus on companies with the two-tiered board structure. Requirements for companies with a single-tier, or monistic board, are set forth in ch. IV and generally mirror, to the extent possible, the dualist structure.
[156] Fifth Directive, art. 5.
[157] Fifth Directive, art. 7.
[158] Fifth Directive, art. 3(2).
[159] Fifth Directive, art. 12.
[160] Fifth Directive, art. 8.
[161] Fifth Directive, art. 13.
[162] Fifth Directive, ch. V.
[163] Fifth Directive, ch. VI.
[164] Fifth Directive, art. 4b (the German model).
[165] Fifth Directive, art. 4c (the Dutch model).
[166] Fifth Directive, art. 4d.
[167] Fifth Directive, art. 4e.
[168] There was resistance to the required two-tiered board structure, but the provisions for the monistic approach appeared to have settled that problem.
[169] USITC staff meetings with a member of DC XV, Apr. 19, 1989; with members of the German Ministry of Justice, Apr. 27, 1989; and with a member of the Office for Company Law in DIHT, Apr. 27, 1989.
[170] USITC staff meetings with a member of DG XV, Apr. 19, 1989, and with members of the Companies Division, DTI, Apr. 20, 1989.
[171] USITC staff meeting with an attorney from Coudert Freres and a member of the Office of Prime Minister Rocard of France, Apr. 24, 1989.
[172] USITC staff meeting with members of the German Ministry of Justice, Apr. 27, 1989.
[173] USITC staff meetings with members of the Companies Division, DTI, Apr. 20, 1989, and with members of the German Ministry of Justice, Apr. 27, 1989.
[174] It is important to distinguish this directive from the proposed regulation on control of concentrations. Whereas the concentration regulation addresses what mergers may take place, this Directive merely coordinates how such a merger, once allowed, will take place.
[175] See footnote 141, above.
[176] USITC staff meeting with a member of DG XV, Apr. 20, 1989.
[177] Ibid.

on the Fifth Directive, the Parliament may decide to act on the Tenth Directive.[178]

Eleventh Directive

The EC Commission introduced the Eleventh Directive to relieve certain branches of disclosure requirements. If a branch is located in a member state other than that in which the head office is located, the branch will not be required to disclose its accounts if it publishes the annual accounts and annual report of the company.[179] The Directive does direct the branch to disclose general information, such as the name and address of the branch, the object of the activities of the branch, and the existence of other branches in the member state.[180] If the head office is located outside the EC, additional disclosure is required, such as the governing law in the third country, the articles of incorporation and the by-laws of the head office.[181] The accounts of the company, if registered in a member state, will be in accordance with the Fourth and Seventh Company Law Directives.[182] If, however, the company is registered outside the European Community, the accounts must be either in conformity with the Fourth and the Seventh Company Law Directives,[183] or equivalent thereto.[184] In addition to the question of equivalence, the one other issue of potential concern, for both European and American firms, is the language in which the accounts must be submitted. If, as proposed by the Greeks, the accounts must be published in the language of the host country, the translation into numerous languages could create large costs.[185]

Possible Effects

Fifth Directive

The directive on the structure of public limited companies may change the relationship between European subsidiaries of U.S. companies and their employees. Depending on how the question of which scheme of worker participation the member state can chose is decided, companies may face only slightly increased worker participation requirements than at present. Because the Fifth Directive, as with all these Directives, applies to companies registered in a member state, the company must already be in conformity with the EC law. This requirement could affect the way U.S. firms operate in Europe, but a U.S. subsidiary will not face any greater change than would a domestic company.If the German system becomes the EC system, some companies, of whatever parentage, may be adversely affected if they have had no experience with worker participation. It appears unlikely, however, that this provision will play a large role in a company's analysis of whether to open a plant in a particular member state, as it is only a small issue among other, more important considerations.[186] The required two-tiered structure is similar to that in the United States, as are many of the procedural requirements, and should not therefore cause any serious problems.

Tenth Directive

The directive on cross-border mergers should better enable companies in the European Community to exploit the economic opportunities of the single EC market. It will allow companies in EC member states to reorganize, for instance, by merging their various subsidiaries, currently placed in different parts of the EC. This restructuring will allow companies to take advantage of economies of scale and lowering per-unit costs.[187] In addition, market access into each individual country will now be a less important factor in investment decisionmaking, another factor in stimulating consolidation within companies. This could reduce investment and overhead costs for companies. The Tenth Directive does not seem to exclude U.S. subsidiaries but treats them as it would any firm registered in a member state. The benefits produced by this Directive, however, may enhance the competitiveness of products produced in the European Community compared with U.S. exports.

Eleventh Directive

By coordinating and standardizing disclosure requirements for branches opened within a member state and by removing regulations that have been rendered superfluous as a result of EC harmonization, the Eleventh Directive will probably prove trade liberalizing. Although the question of equivalence is still unsettled, the EC Commission is undertaking negotiations with the U.S. Securities and Exchange Commission (SEC) on the mutual recognition of accounting

[178] Ibid.
[179] See Eleventh Directive, art. 2.
[180] Eleventh Directive, art. 2.
[181] Eleventh Directive, art. 6.
[182] See footnote 141, above. USITC staff meeting with members of the Companies Division, DTI, Apr. 20, 1989.
[183] See footnote 141, above.
[184] USITC staff meetings with a member of DG XV, Apr. 19, 1989; with members of the Companies Division, DTI, Apr. 20, 1989; and with a member of the Office for Company Law in DIHT, Apr. 27, 1989. The member states retain the authority to determine what is "equivalent" (art. 10), but a party can always appeal the decision to the European Court of Justice. USITC, staff meeting with a member of the Office for Company Law in DIHT, Apr. 27, 1989.
[185] USITC staff meetings with member of the German Ministry of Justice, Apr. 27, 1989, and with a member of the Office for Company Law of DIHT, Apr. 27, 1989.
[186] USITC staff meeting with members of the German Ministry of Justice, Apr. 27, 1989.
[187] USITC staff meeting with a member of DG XV, Apr. 19, 1989.

standards.[188] Officials in the United Kingdom seemed confident that accounting standards required by the SEC will be considered equivalent in the EC.[189] The additional disclosure requirements imposed on branches of U.S. companies may present a problem for those small or privately held companies that do not currently (follow SEC accounting requirements.[190])

Views of Interested Parties

No formal submissions were received.

[188] Correspondence of John Hegarty, Secretary General of the Federation des Experts Comptables Europeens, dated Feb. 7, 1989.
[189] USITC staff meeting with members of the Companies Division, DTI, Apr. 20, 1989.
[190] USITC staff meeting with a member of DG XV, Apr. 19, 1989.

CHAPTER 10
TAXATION

CONTENTS

Chapter 10

Taxation

Introduction

To date, the EC has focused principally on two areas of tax harmonization—(1) approximation of indirect taxes, such as the value-added tax (VAT) and excise duties, and (2) establishment of a common system of withholding tax on interest income. The former relates to the need to approximate indirect taxes if border frontiers are to be removed, and the latter relates to efforts to liberalize capital movements. In August 1987, the EC Commission issued a comprehensive fiscal package, including seven proposed directives, covering VAT and excise duties. In May 1989, the EC Commission issued a communication addressing problems related to the 1987 package. The communication is expected to serve as a basis for discussion and, eventually, for amendments to the proposed directives. In January 1989, the EC Commission issued a proposed directive on a common system of withholding tax on interest income. This chapter focuses principally on the measures relating to indirect taxes. The measure relating to the withholding tax on interest income is described briefly below, but was received too late for the USITC to analyze it in detail or to obtain industry views.

Harmonization of Indirect Taxes—VAT and Excise Duties

The 1985 White Paper stated that it would be impossible to remove frontier controls and thus the frontiers themselves "if there are significant tax and corresponding price differences between the member states."[1] It concluded that the removal of frontiers and associated controls would require not only the setting up of an EC clearinghouse system for the VAT and a linkage system for bonded warehouses for excised products, but also a considerable measure of approximation of indirect taxes.[2]

The 1988 Cecchini report reaffirmed these conclusions, identifying differing fiscal barriers, especially differing rates of VAT and excise duties, as barriers that had to be removed if the goals of integration are to be achieved.[3] The report estimated that the cost to companies of filing the forms related to VAT, excise taxes, and other border formalities amounts to about 1.5 percent of the value of the goods in the transaction.[4] Other sources estimate that more than 90 percent of the paperwork involved with the movement of goods across member-state borders is documentation related to VAT.[5]

The task of harmonizing differing tax systems is one of the most difficult facing the EC, in large part because changes in rates and methods can materially affect member state revenues and affect social policy. The provisions in the Single European Act related to taxation reflect these difficulties. In amending article 99 of the Treaty of Rome, the act required that the European Community Council (Council) actions directed at harmonizing indirect taxes be adopted unanimously rather than by the majority vote required for many other actions.[6]

In August 1987, the EC Commission presented to the Council a "fiscal package" consisting of a "Global Communication" describing its indirect taxation proposals, seven proposed directives, and a working paper on the VAT clearing mechanism. The package remains outstanding, with many difficult issues to be resolved, particularly with respect to VAT rates, excise duties, and the clearinghouse mechanism. A May 1989 communication from the EC Commission to the Council and European Parliament seeks to address many of these issues and propose solutions. The communication is expected to become the basis for amendments to the proposed directives.

The EC Commission in its midterm progress report on the 1992 program adopted in November 1988 stated that progress in harmonizing indirect taxes has been "disappointing."[7] In its fourth progress report, made available in June 1989, the EC Commission noted its May communication and stated that progress had begun in the form of discussions on harmonization of indirect taxation but identified

[1] EC Commission, *Completing the Internal Market: White Paper from the Commission to the European Council* (1985), par. 175, p. 44 (hereinafter White Paper).
[2] Ibid., par. 184, p. 46.
[3] P. Cecchini, *The European Challenge 1992: The Benefits of a Single Market* (1988) (hereinafter Cecchini report).
[4] Ibid, p. 7.
[5] McCartney, "Europe Seeks an Economy of Scale," *Washington Post*, Mar. 19, 1989, p. 30.
[6] Art. 17, Single European Act, effective July 1, 1987, reprinted at 1986 *EC Bulletin*, supp. 2.
[7] EC Commission, "Completing the Internal Market: An Area Without Internal Frontiers, The Progess Report Required by Article 8B of the Treaty," (88) 650 final, Nov. 17, 1988, p. 7. With respect to tax matters, the report stated the following (in pertinent part—at p. 7):

> The critical issue in the fiscal field is the harmonization or approximation of indirect taxation. There is simply no way that the objectives of the Single Act—particularly the removal of the internal frontiers and the controls which go with them—can be achieved without removing the fiscal reasons for frontier controls. . . . Despite the remit given by the European Council at Milan in June 1985, reinforced by the terms of the Single Act itself, there has been great reluctance on the part of the relevant Council to face up to the issues involved; much time has been wasted in going over the same ground again and again and in re-examining so-called alternatives which have repeatedly been rejected as often as not by the the Member States themselves.

taxation as one of the four areas that are furthest behind schedule. [8]

As explained in the Global Communication, the August 1987 fiscal package is "a blueprint for the abolition of fiscal frontiers," and is "not an attempt to design an ideal fiscal system for the Community."[9] It is "confined . . . to setting out the minimum changes which must be made . . . in order to achieve a sufficient degree of fiscal approximation."[10] It thus reflects the objective set forth in amended article 99 of the Treaty of Rome of harmonizing indirect taxes to the extent necessary "to ensure the establishment and functioning of the internal market" by the end of 1992.[11]

The fiscal package does not address other forms of indirect taxes, such as those on the registration of vehicles or purchase of houses, since such taxes do not impede the free flow of goods across borders and give rise to border formalities.[12] It focuses on indirect taxes, as opposed to direct taxes such as income taxes, largely for two reasons.[13] First, value added taxes and excise duties are collectible at the borders and directly affect almost every border transaction; border controls are to be eliminated by the end of 1992. Second, the differences between member state direct tax systems are even greater than those between member state indirect tax systems.

Proposed Directives Relating to VAT

In 1958, when the Treaty of Rome entered into force, only France had a VAT. Most of the other original members imposed other forms of turnover tax, generally in the form of a cascade system. The First and Second VAT Directives, adopted in February 1967, required a general harmonization of turnover taxes in the form of a noncumulative VAT.[14] The systems imposed by the member states were brought into further harmony by the Sixth VAT Directive, adopted in May 1977. However the directives did not specify rate levels, the number of rate classes, or the goods and services to be covered in a given class.

All 12 member states have adopted a VAT. The VAT in place in the EC is, in essence, a consumption or sales tax. It is imposed on most goods and services. It is paid by the taxpayer who produces or contributes to the good or provides the service, and it is included in the sale price rather than added to it, as in the case of a U.S. sales tax. It is based on the value that the taxpayer contributes to the good or service. More technically, as the German term for the tax states ("Nettournasatzsteuer mit Vorsteuersbzus" —net turnover tax with prior tax deduction), the taxpayer pays tax on the full sales price of the good or service and receives a credit for VAT paid by those who provided the goods or services used in producing or providing the goods or services. For example, in the case of an automobile, the manufacturer of the finished automobile pays VAT on the full sales price of the automobile but is credited for VAT paid by his suppliers of parts and other materials. The consumer who purchases the automobile pays no VAT (although the VAT is reflected in the purchase price) and receives no VAT credit. [15]

No 2 of the 12 member states presently maintain identical VAT systems. Average rate levels, the number of rates levied, and rates applicable to various goods and services vary significantly from country to country. As of late 1988, member states imposed from one to upwards of six different rates. Six of the 12 members impose a luxury rate, and definitions of "luxury" vary. The United Kingdom, for reasons

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[7]—*Continued*
At long last some progress is being made but it is essential that this progress should not only be sustained but accelerated. Time is now very short and further delay will only make more difficult the problems to be confronted on 31 December 1992 when the internal frontiers have to go.

[8] EC Commission, "Fourth Progress Report of the Commission to the Council and the European Parliament Concerning the Implementation of the Commission's White Paper on the Completion of the Internal Market," COM (89) 311 final, June 20, 1989, pp. 3, 10 (hereinafter Fourth Progress Report).

[9] EC Commission, "Completion of the internal market: approximation of indirect tax rates and harmonization of indirect tax structure. Global Communication from the Commission," COM(87) 320 final, Aug. 5, 1987, p. 3 (hereinafter Global Communication).

[10] Ibid.

[11] Art. 99.

[12] Global Communication, p. 7.

[13] According to Per Brix Knudsen, EC official with responsibility for indirect taxes, at a conference hosted by the Confederation of British Industry May 23, 1988, as paraphrased in Durkacz, "Comment," *Taxation* (June 10, 1988), p. 207.

[14] See generally, H. Smit and P. Herzog, *The Law of the European Economic Community*, 1982, vol. 3, pp. 463 to 464, 466 to 467. Adoption of a VAT was recommended by the Neumann Report in 1962. A principal purpose in adopting a VAT was the elimination of cascade turnover taxes. Such taxes were fully assessed at each turnover, but without a credit for prior taxes. They favored vertically integrated manufacturers and were considered to distort trade and commerce. As in the case of VAT, they were imposed on imports and rebated on exports. These taxes posed particular problems in the case of imports and exports because they were based on arbitrary assumptions as to the number of times that an article had been turned over. A bias in estimating the number of turnovers could benefit exports and discriminate against imports. By Jan. 1, 1973, all six members of the EC (the number of members at that time) had implemented a VAT in accord with the two directives. See generally, A. Tait, *Value Added Tax* (1972), pp. 6 to 9, 87 to 88, 146 to 147; and R. Lindholm, *Value-Added Tax and Other Tax Reforms* (1976), p. 46.

[15] As made clear in a recent decision of the European Court of Justice, the VAT must be levied on the actual price paid by the consumer, not on a theoretical price such as a catalogue (list) price. *Commission v. Belgium*, case 391/85, Feb. 4, 1988.

of domestic social policy, zero-rates (imposes no VAT on) foodstuffs and certain other necessities and imposes a rate of 15 percent on most other goods and services, but has no luxury rate. Italy imposes reduced rates of 2 and 9 percent on certain necessities, a rate of 18 percent on most other goods and services, and a rate of 38 percent on luxury goods. Denmark, on the other hand, imposes only one rate—of 22 percent—the highest in the EC, on most goods and services. Relative revenue effects vary accordingly. As reported in the White Paper, in 1982 VAT revenues as a percentage of GDP ranged from a low of 5.22 percent in the United Kingdom to a high of 9.84 percent in Denmark.[16] Trade distortions related to differing national VAT rates are largely eliminated by the fact that adjustments are made at the borders, which means that Belgian consumers, for example, cannot avail themselves of neighboring Luxembourg's rate of 12 percent on high-powered automobiles and avoid the 33-percent Belgian rate.

The fiscal package presented in August 1987 contained four basic documents related to VAT—three proposed directives and a working paper on a VAT clearing mechanism:

Document No.	*Short Title*
(87) 321	Proposed Directive—Approximation of VAT Rates
(87) 322	Proposed Directive—Abolition of Fiscal Frontier
(87) 323	Outline Working Paper for a Community VAT Clearing Mechanism
(87) 324	Proposed Directive—Institutes a Process for Converging VAT and Excise Duty Rates

Proposed directive (87) 321, the key measure, would require member states to (1) impose a dual-rate VAT system, (2) standardize the goods and services subject to each rate, and (3) set rates at a level within specified rate bands. In selecting a dual-rate system, the EC Commission concluded that this system has the "advantage of flexibility and ease of administration and limits difficulties of interpretation arising from the criteria for classifying products."[17] The EC Commission observed that a single VAT rate system was in theory the simplest, but noted that all but two members, Denmark and the United Kingdom, applied two or more rates. The EC Commission concluded that "it would seem desirable not to upset the tax structures of the majority of Member States."[18]

[16] White Paper, table 1, p. 47.
[17] "Explanatory Memorandum" to COM(87) 321 final, Proposal for Council Directive, completing the common system of value-added tax and amendment of Directive 77/388/EEC—Approximation of VAT rates, p. 1.
[18] Ibid.

The EC Commission proposed two rate bands, one for a standard rate and one for a reduced rate, "[i]n an attempt on the one hand to allow a margin for optimum fiscal manoeuvrability and on the other hand to minimize budgetary repercussions for the greatest number of Member States . . . ."[19] The standard rate set by a member state could vary between 14 and 20 percent, and the reduced rate could vary between 4 and 9 percent. The rate band differential was largely consistent with that suggested in the White Paper, which, in referring to sales taxes levied in the United States, stated that differences of up to 5 percent between neighboring States could exist without undue adverse effects.[20] The proposed directive contains no provision for zero-rating, except in the case of exports.[21]

The reduced rate would be applied to the following goods and services:

foodstuffs, excluding alcoholic beverages
energy products for hearing and lighting
water supplies
pharmaceutical products
books, newspapers, and periodicals
passenger transport.

The purpose in drawing up the list was to ensure that the same type of product or service is placed under the same category in each member state, "thus avoiding systematic deflections of trade."[22] In devising the list, the EC Commission took into account the division of products and services existing at the present time in the majority of member states.[23]

The EC Commission sought to minimize the budgetary effect that the rates would have on the various member states. Nevertheless, it concluded that Ireland and Denmark would suffer pronounced budgetary losses; France would suffer a slight budgetary loss; Luxembourg, Spain, and Portugal would obtain substantial increases in budgetary receipts; West Germany, the United Kingdom, and Greece would obtain small or moderate increases; and Belgium, Italy, and the Netherlands would have little or no change.[24]

The second of the proposed directives, (87) 322, contains various proposals to amend existing directives, establish certain rules, and end certain

[19] Ibid.
[20] White Paper, par. 185, p. 46.
[21] Citing the Second and Sixth VAT Directives, the Global Communication (pp. 12 to 13), states that zero-rating (except in the case of exports) has always been considered a "temporary" measure that would disappear with the completion of the internal market. It states that zero-rating is a less efficient way of achieving social policy objectives than measures more closely targeted to such needs.
[22] Explanatory memorandum to COM(87) 321, p. 2.
[23] Ibid.
[24] Global Communication, p. 19. The budgetary impact estimates include the projected effect of changes in excise taxes.

derogations related to the abolition of fiscal frontiers. For example, it would amend the Sixth Directive so as to provide that the terms "import" and "export" will apply only to trade with third countries.

The third document in the package, the working paper for a VAT clearing mechanism (document No. (87) 323), sets forth a basic outline for such a mechanism but does not provide a detailed proposal for a legal instrument.[25] A proposed directive is expected later in 1989.[26] The clearing mechanism would ensure that tax collected in the exporting country is reimbursed to the importing country in order that all VAT revenue would continue to accrue to the country of final consumption. The mechanism would consist essentially of a central account managed by the EC Commission. Net exporting countries would be required to pay into the account and net importing countries would receive payments from it. Payments and refunds would be made on the basis of a monthly declaration from each member state of its total VAT (input plus output) figures for intra-EC trade.

The fourth document and third proposed directive provides for institution of a process of convergence of VAT and excise duty rates (document No. (87) 324). In general, VAT is levied on goods that are also subject to excise duties. In recognition of the fact that member states impose different VAT rates and maintain different excise duty structures,[27] the proposal would (1) prohibit member states from taking actions that widen any divergences in rates, but (2) encourage member states to narrow divergences by modifying present rates in a manner that brings them closer to the VAT and excise duty rates and structures set forth in the other proposed directives in the fiscal package.[28]

Member-state officials have expressed a number of concerns about the proposed directives. The United Kingdom is opposed to eliminating its zero-rating of food and children's clothing and is concerned about the additional regulation and bureaucracy that would be required to ensure a fair allocation of revenues among member states through the clearing mechanism. The United Kingdom favors a more gradual approach in reduction of frontier controls and a progressive increase in the allowances for taxes paid by citizens of one country to other EC countries.[29] France questions whether the principle of approximation can be carried out before 1992, is concerned about the 5-to 6-point band ranges as well as the allocation system, and believes that the only real urgency is harmonization of the withholding tax on savings.[30] Denmark is concerned about potential revenue loss if it must reduce its rates and estimates such loss at 5 billion ECU, or 6 percent of its GNP.[31] Luxembourg, which has the lowest rates in the EC, is concerned that higher rates would adversely affect its sales to visitors from other EC countries.[32] Ireland would be faced with the dual problems of revenue loss and elimination of zero-rating of foodstuffs and certain other necessities.[33] The Netherlands is also concerned that the rate bands are too wide and might create trade distortions.[34] In general, only two member states have come out in favor of the EC Commission proposal—Germany and the Netherlands.[35] Both impose tax rates that are approximately at midrange within the proposal. Criticism of the proposed clearing mechanism focuses on its centralized administration, its potential as a source of budgetary conflict between member states, and the risks of distortion of competition resulting from "excessive" rate differences between member states.[36]

[25] See generally EC Commission, "Completing the Internal Market—The Introduction of VAT Clearing Mechanism for Intra-Community Sales, COM(87) 323 final/2 (1987); EC Economic and Social Committee, "Opinion on completing the internal market: The introduction of a VAT clearing mechanism for intra-Community Sales," *Official Journal of the European Communities*, No. C 237/24 (Dec. 9, 1988); and M. Van Beek, "Indirect Taxation and 1992," 9 *Northwestern Journal of International Law & Business* (1989), p. 561.

[26] See Annex 3 to the Fourth Progress Report, p. 87.

[27] Global Communication, p. 15.

[28] EC Commission, Explanatory Memorandum in "Proposal for a Council Directive instituting a process of convergence of rates of value added tax and excise duties," COM(87) 324 final/2, p. 2.

[29] Remarks of Chancellor of the Exchequer Nigel Lawson on Sept. 8, 1988, as reported in 5 *Int'l Trade Rptr.* 1234 (Sept. 14, 1988). See also "Taxation: Debate on VAT Approximation Starts on the Wrong Foot," *Economic and Monetary Affairs* 1395 (Apr. 9, 1988); and "Taxation: Member States Recognise Need for Indirect Tax Approximation," *Economic and Monetary Affairs* 1398 (Apr. 20, 1988), p. 8.

[30] Statements of Prime Minister Michel Rocard, as reported in "France Sees No Quick Path to Europe Tax Alignment," *Wall Street Journal*, Sept. 12, 1988, p. 16; remarks of French Representative to the EC Alain Juppe, as reported in "Taxation: Member States Recognise Need for Indirect Tax Approximation," *Economic and Monetary Affairs* 1398 (Apr. 20, 1988), p. 7; and remarks of Prime Minister Rocard as quoted in a Sept. 9, 1988, interview in *L'Expansion*, as reported in 5 *Int'l Trade Rptr.* 1234 (Sept. 14, 1988).

[31] "Taxation: Member States Recognise Need for Indirect Tax Approximation," *Economic and Monetary Affairs* 1398 (Apr. 20, 1988), p. 7. As of early July 1989, one ECU equalled $1.08 U.S. The rate changes daily.

[32] "Taxation: Debate on VAT Approximation Starts on the Wrong Foot," *Economic and Monetary Affairs* 1395 (Apr. 9, 1988).

[33] "Taxation: Member States Recognise Need for Indirect Tax Approximation," *Economic and Monetary Affairs* 1398 (Apr. 20, 1988), pp. 7 to 8.

[34] Ibid., p. 7.

[35] "Taxes: Tax Reform Package Presented to Finance Council; No Agreement on 18th VAT Directive," *Economic and Monetary Affairs* 1358 (Nov. 18, 1987), p. 2.

[36] EC Commission, "Completion of the Internal Market and Approximation of Indirect Taxes: Communication from the Commission to the Council and to the European Parliament," COM(89) 260 final, June 14, 1989, p. 5 (hereinafter 1989 communication).

In May 1989, the EC Commission adopted a communication (COM(89) 260) outlining a series of suggestions and modifications to its existing proposals in the field of indirect-tax approximation. The "new approach" outlined in the communication does not change the EC Commission's basic goal of eliminating intra-EC fiscal frontiers and frontier-related controls and ensuring that sufficient approximation of VAT and excise rates takes place.[37] However, the communication acknowledges that "major disagreements" continue to exist as to the method for achieving this goal.[38] A working party will be studying the new approach, and it is expected to make its report at the ECO/FIN meeting in October; the timetable beyond October cannot be determined at this time.[39] However, at the Madrid meeting of the European Council in late June, the Council emphasized the need to reach agreement on the broad lines of a solution in this area before the end of the year in order to insure that the internal market comes into operation on schedule.[40]

The new approach contains three basic elements: (1) Creation of a transitional phase lasting until the end of 1992, during which member states would be expected to make a positive commitment towards alignment of indirect taxes; (2) "[p]ragmatic" solutions to certain problems in the field of VAT, including a minimum standard rate of VAT and no upper limit, limited zero-rating, a "differentiated" clearing approach for certain transactions, and simplification of residual VAT clearing procedures; and (3) improved flexibility in relation to excise duty rates.[41]

With regard to the transitional phase, the communication suggests the introduction of a transitional period for implementation of new VAT and excise duty rates in order to minimize economic disruption and budgetary consequences; the introduction of certain procedural simplifications, particularly with respect to transit, including abolition of the transit advice note; and, with respect to travelers' allowances, a staged quadrupling of the value of the VAT allowances and doubling of the specific quantitative allowances for excisable products.[42]

The communication addresses three matters with respect to the approximation of VAT rates: the width of the bands, which the communication stated is often regarded as excessive and likely to bring about distortions of competition, notably in the case of the standard-rate band; the products to be charged with VAT at the reduced rate; and the problem of zero-rated products.[43] The communication suggests replacing the standard-rate band with a minimum rate, without an upper limit, which would be applicable from January 1, 1993. Each member state would choose a rate at least equal to the minimum, taking into account the rate's national budgetary implications as well as the competitive pressures that would result from rates chosen by neighboring member states and by main trading partners.[44] The communication states that the EC Commission still considers the proposed 4- to 9-percent reduced-rate band to best meet the EC's needs and states that the essential task is to agree on the products to be taxed at this rate.[45] The communication states that a "relaxation" of the EC Commission's position that zero-rating is a temporary derogation "could be envisaged" provided a number of conditions are met. In the "framework of a final compromise," member states who so wish could maintain zero-rating for "a very limited number" of products currently subject to the reduced rate, provided this did not pose any risks of distortion of competition for the other member states.[46]

To simplify the clearing mechanism process, the communication suggested a new approach whereby a number of transactions would be treated differently, at least while the rates are insufficiently aligned, and whereby a system of clearing (in the form of refunds) would be envisaged only for residual transactions between taxable persons. This "differentiated" approach would apply in the case of mail-order selling, wherein sales would be taxed under the conditions applicable in the country of destination of the goods; sales of cars, wherein place of supply would be defined as the place of registration; sales to institutional nontaxable persons (e.g., public institutions) and exempt taxable persons (e.g., banks and insurance companies), wherein a self-supply procedure or differential tax would apply; and transactions of enterprises linked within the same group and certain associated small and medium-sized firms, wherein chargeability of VAT would be deferred to the time of resale to a nonapproved, nonassociated purchaser.[47]

For the remaining transactions, the communication suggested a "macroeconomic approach" to the clearing operation, whereby debits and credits of the member states would be calculated on the basis of trade statistics rather than VAT returns of taxable persons. There

[37] Fourth Progress Report, p. 25.
[38] Ibid., pp. 1, 2.
[39] Conversation with a representative of the EC Delegation in Washington, July 7, 1989.
[40] Conclusions, Madrid European Council, June 26 to 27, 1989.
[41] Fourth Progress Report, p. 25. The new approach regarding excise duties is discussed below in the section relating to excise taxes.
[42] 1989 communication, pp. 2 to 3.
[43] Ibid., p. 4.
[44] Ibid.
[45] Ibid.
[46] Ibid., p. 5.
[47] Ibid., pp. 6 to 8. Under the self-supply procedure, the institution would be considered to have self- supplied the good, and the good would be taxable under the conditions applicable at the place of supply. Several member states have already suspended application of VAT to transactions of linked enterprises pursuant to art. 4(4) of the Sixth VAT Directive.

would be no central clearing fund; only an accounting exercise designed to establish the surplus balances to be refunded.[48]

Possible effects: approximation of VAT rates and converging of VAT and excise rates

U.S. exports to the EC.—In general, government and private financial analysts do not consider it likely that the proposed tax directives as set forth in the 1987 fiscal package, if implemented in that form, will have a significant impact on U.S. exports to the EC. However, financial experts suggest that the implementation of the directives will facilitate the operations of all firms (regardless of the country of ownership) doing business in the EC. Firms operating in the EC must contend with a wide variety of direct and indirect national tax rates and structures that are considered to be cumbersome.

Harmonization of indirect tax rates and structures should help in several ways. First, for firms operating in more than one member state, harmonization (in conjunction with the elimination of frontiers) should substantially reduce the paperwork and delay currently associated with the movement of goods across member state borders and thus reduce the cost of moving goods between member states. Second, the savings in border-crossing costs should make firms based in one member state more competitive in the home markets of firms located in other member states. Third, for firms conducting limited operations in the EC or contemplating the commencement of operations, standardization of rates and structures should make expansion or commencement of operations less forbidding and less complicated.

Harmonization of VAT rates is likely to affect prices on many goods in the EC, but such price changes will vary from country to country and will largely be determined by the magnitude of the change in rates on a particular good in a given country. U.S. exports of goods affected by such changes are likely to rise or fall—but probably only by marginal amounts—depending on the magnitude of the change in rate on a given good and the price elasticity of the good. For example, because Italy's current VAT rate for luxury items is 38 percent, luxury rates are to be eliminated, and the applicable standard rate is likely to be substantially lower, U.S. exports of "luxury" items to Italy may increase marginally. However, it is possible that other governmental actions will in part offset some of the changes in rates. Because the directives may simplify EC tax systems, there could be a reduction in certain costs for EC firms, which might lead to a decline in the prices of EC products. At the same time, any reductions in price that result from implementation of the directives are not expected to benefit EC firms so as to lead to a significant decrease in U.S. exports to the EC.[49]

Diversion of trade to the U.S. market.—Because the tax directives are considered unlikely to significantly affect EC imports, it is unlikely that there will be a diversion of trade from the EC to the United States.

U.S. investment and operating conditions in the EC.—On an overall basis, the proposed directives, if implemented, are expected to have a neutral to positive effect in terms of U.S. investment and operating conditions in the EC. One financial analyst suggested there is a possibility that some establishments in the EC (regardless of nation of ownership) may, in one sense, be negatively affected by the excise tax and VAT directives. When a U.S. company makes a decision to locate in a particular EC country, tax rates of the country are nearly always considered. If the tax rates change as a result of these directives, an establishment's location may be more, or less, of a positive financial factor than it was previously. Whether the change is positive or negative for a particular establishment depends on a variety of factors, including how the tax rates change with respect to the tax rates of other countries. Given the fact that the tax rates are rarely a critical location factor, and because the rates would converge to a relatively narrow range, it seems unlikely that the effects, either positive or negative, will be substantial. In addition, U.S. firms should not be affected more than those of any other country.

West Germany and the United Kingdom account for the largest share of U.S. investment in the EC; the tax directives are not expected to change the business environment appreciably in these countries. On the other hand, although tax laws are but one variable in the decision to invest in any one member state, these directives could encourage U.S.-owned firms to invest in countries such as Spain and Portugal, which maintain other comparative advantages, such as lower labor costs. In addition, a reduction in or

[48] 1989 communication, pp. 8 to 9.

[49] Of course, prices between member states differ for reasons other than VAT. A study based on 1985 data for a basket of more than 300 consumer goods for the then nine member states showed a weighted- average dispersion of prices exclusive of tax of slightly above 15 percent. However, price discrepancies between two countries for the same product were much broader. For example, whereas the dispersion of prices exclusive of tax is 14 percent for cars, bicycles, and motorcycles, the absolute discrepancy between the two extreme cases (Denmark and the United Kingdom) is 55 percent; in the case of refrigerators and washing machines, the dispersion is 10 percent and the absolute discrepancy (Italy and France) is 39 percent. These differences greatly exceed the maximum discrepancies of 5.2 percent resulting from differing VAT rates. See E. Rui Vilar, "Consequences of Tax Frontier Abolition," *European Affairs* (spring 1989), p. 38. The author is Director General of the Customs Union and Indirect Taxation (DG XXI) of the EC.

elimination of cross-border VAT documentation costs may encourage wider sourcing of raw materials from suppliers in other member states, may make it more feasible to decentralize EC manufacturing operations to take advantage of lower labor and other costs in other member states, and may reduce present disincentives to locate production and other facilities in states with small markets.

U.S. industry response

Financial analysts from a number of major consulting firms and major U.S. companies with EC investments do not anticipate any specific response from U.S. industry to the directives. This view is consistent with the general perception that the directives are of minimum significance to U.S. business operations. Those interviewed consider the directives to be more of an initial move towards a favorable harmonization of the EC tax laws rather than a major change in present laws.

Views of interested parties

No formal submissions were received.

Proposed Directives Relating to Excise Taxes

The divergence in member-state excise rates is much greater than in the case of VAT.[50] The White Paper called for the approximation of excises on cigarettes, other manufactured tobacco products, alcoholic drinks, and mineral oils; imposition or extension of excises on wine where necessary; and the reduction or abolition of all other excises that would create a distortion in the Common Market, such as those on coffee and tea.[51]

Although a less significant source of tax revenue than the VAT, excise taxes are nevertheless an important source of revenue in most member states. As measured as a percentage of GDP in 1982, excise taxes on tobacco products, beer, wine, spirits, and mineral oil products ranged from 1.92 percent in the Netherlands to 7.63 percent in Ireland.[52] As measured in ECU (as of Apr. 1, 1987), excise taxes on pure alcohol content ranged from 48 per hL (100 liters) in Greece to 3,499 in Denmark; on wine, from 0 in Greece, Spain, Italy, and Portugal to 279 per hL in Ireland; on beer, from 3 per hL in Spain and France (7 in Germany) to 56 in Denmark and 82 in Ireland; and on petrol, from 209 per 1,000 liters in Luxembourg to 557 in Italy.[53] For cigarettes, excise rates range from 0.6 per thousand in Greece to 77.5 per thousand in Denmark, but ad valorem taxes (excise taxes and VAT combined), as measured as a percentage of the retail price, range from 33.6 percent in Ireland to 71.1 percent in France.[54]

The four proposed directives included in the fiscal package, and descriptions thereof, are as follows:

Document No.	*Short Title*
(87) 325	Proposed Directive—Approximate Taxes on Cigarettes
(87) 326	Proposed Directive—Approximates Taxes on Manufactured Tobacco Other Than Cigarettes
(87) 327	Proposed Directive—Approximates Rates of Excise Duty on Mineral Oils
(87) 328	Proposed Directive—Approximates Rates of Excise Duty on Alcoholic Beverages and on the Alcohol Contained in Other Products

The four proposals would provide for uniform product definitions and would impose uniform excise taxes. The proposals call for a specific excise rate rather than a rate band in view of the fact that the goods subject to excise duties will also be subject to VAT and the VAT will be imposed on the price of goods inclusive of excise duty.[55] The EC Commission was of the view that the margin of flexibility of taxing such goods should be reserved for the VAT rates because these rates have by far the widest coverage and therefore have overriding importance for member states' budgets.[56] The proposed rates are shown in table 10–1.[57]

In the case of tobacco products, the rates were calculated on the basis of the EC arithmetic average, giving equal weight to the rates of each member state. This calculation resulted in an overall increase in taxation at the EC level, which is consistent with the EC Commission's health policy objectives. In the case of distilled beverages, the EC Commission used the EC arithmetic average. However, in the case of fermented beverages (beer and wine), the EC Commission decided to tax them equally per liter of product on an overall revenue-neutral basis; a tax based on an arithmetic average or average weighted by consumption would have been highly disruptive. In the case of mineral oils, the EC Commission used an arithmetic average for petrol, which is the most important product in terms of revenue in this sector, and used an average weighted by consumption for diesel, heating gas-oil, and heavy fuel oil.[58]

[50] Global Communication, p. 16.
[51] White Paper, p. 53.
[52] White Paper, table 1, p. 47. Indirect taxes received from such products were actually higher due to varying levels of VAT levied on such products.
[53] As compiled by *European Economy* (March 1988), and reprinted in article by D. Roche, "Europe 1992: What Is It?," *Business America* (Aug. 1, 1988), p. 15.
[54] Ibid.
[55] Global Communication, p. 15.
[56] Ibid., pp. 15 to 16.
[57] Ibid., p. 18.
[58] The rationales for each of the proposed rates described in this paragraph are set forth in the Global Communication, pp. 16 to 17.

Table 10-1

Proposed excise duty rates on alcoholic drinks, manufactured tobaccos, and mineral oils

Commodity	Excise duty rate	Ad valorem plus VAT
	ECU	Percent of retail price
Alcoholic drinks:		
Alcohol for beverages (per hL of pure alcohol)	1,271	(1)
Intermediate products (per hL)	85	(1)
Wine (per hL, average 11% volume)	17	(1)
Beer (per hL, average 12.5 plato)	17	(1)
Manufactured tobaccos:		
Cigarettes specific excise (per 1,000)	19.5	52 to 54
Cigars and cigarillos	(1)	34 to 36
Smoking tobacco	(1)	54 to 56
Other manufactured tobacco	(1)	41 to 43
Mineral oils:		
Petrol, leaded, and medium oils used as propellants (per 1,000 L)	340	(1)
Petrol, unleaded (per 1,000 L)	310	(1)
Liquefied petroleum gas (per 1,000 L)	85	(1)
Diesel (gas-oil) (per 1,000 L)	177	(1)
Heating gas-oil and medium oils used as fuels other than propellants (per 1,000 L)	50	(1)
Heavy fuel oil (per 1,000 kg)	17	(1)

[1] Not available.

Source: Global Communication, p. 18.

Rates of excise duty on alcoholic beverages would decline substantially in Denmark and Ireland, but these countries' ad valorem taxes on cigarettes would rise significantly. France would be required to raise its excise duty on wine and beer nearly sixfold; Germany would be required to more than double its excise duty on beer; and Greece, Spain, Italy, and Portugal would be required to impose an excise duty on wine where none presently exists. Luxembourg, Germany, and the United Kingdom would be required to increase their relatively low duties on gasoline (which encourage the purchase of larger cars), and Italy and Denmark would be required to reduce their relatively high duties on gasoline (which encourage the purchase of smaller cars).

The main criticism that the EC Commission encountered was that the 1987 proposal based on single rates per product for the whole EC lacked flexibility. The criticism reflects a "diversity of situation" that is most difficult to reduce in the case of duties on tobacco and alcohol, wherein differences in duties reflect such factors as public health requirements and whether the member state is a producer of the product.[59]

To resolve the issue, the May 1989 EC Commission communication suggests that excise duties be made more flexible and be based on reference values with long-term targets. The flexibility would take the form of minimum rates or rate bands based on these targets, according to the products in question. The communication stated that the EC Commission was aware that the recent development of health policies and the need to protect the environment justified higher long-term targets than was the case in 1987. In the case of alcohol and tobacco, the EC Commission will propose differentiated minimum rates, which will vary according to the principal products and will be compulsory beginning January 1, 1993. The minimum rates will take into account the rates of countries with low excises, yet will not prevent countries with higher excises from progressively aligning their duties on the long-term reference values for each category. In the case of mineral oils, the communication noted the potential for competitive distortion to result from divergences in duties between member states. The communication stated that the EC Commission will propose either single rates or rate bands for different products but without rejecting a priori the fixing of minimum rates in certain circumstances.[60]

Possible effects: Harmonization of taxes on cigarettes and other manufactured tobacco products

U.S. exports to the EC.—The potential exists for proposed directives (87) 325 and (87) 326 to be trade discriminatory against the United States. U.S. manufactured tobacco products (especially cigarettes), both exported directly from the United States and manufactured by U.S. companies in the EC, are generally high-value items in comparison to most other manufactured tobacco products in the EC market. As stated above, the proposed directives would increase the average EC tax (VAT plus excise) on manufactured tobacco products. The directives

[59] 1989 communication, p. 9.

[60] Ibid., pp. 9 to 11.

could cause typical U.S.-type tobacco products to suffer increased price and margin disadvantages versus, particularly, the mainstream products of state tobacco monopolies in France, Italy, Spain, and Portugal. Industry sources indicate that U.S. manufacturers account for about 30 percent of the EC market and that the EC market is sourced primarily by U.S. manufacturers from within EC manufacturing locations. It might also be noted that the United States exports substantial quantities of relatively high-value unmanufactured tobacco to the EC for use in the production of manufactured tobacco products, especially cigarettes. Discriminatory ad valorem excise taxes on tobacco products made in the EC could also affect the exports of this tobacco. It does not appear that these directives would result in any special benefits for U.S. exporters.

The U.S. cigarette industry would be likely to be harmed the most, since cigarettes account for the majority of U.S. exports of manufactured tobacco products (91 percent, by value, in 1988) to the EC. The EC is the largest export market for U.S. cigarettes and accounted for 29 percent of total U.S. exports in 1988, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	768
Japan	606
Canada	12
Total world	2,645

During 1984–88, annual U.S. exports of cigarettes to the EC increased from $302 billion to $768 billion or at an average annual rate of 26 percent, reflecting a general increase in popularity for American-style cigarettes. Trade sources report that a substantial percentage of U.S. cigarettes imported into the EC (especially Belgium) are subsequently shipped to other markets in Africa and Asia.

In 1988, total U.S. cigarette exports were equivalent to 17 percent of U.S. production and U.S. exports to the EC were equivalent to about 4 percent of U.S. production. The EC, accounting for 29 percent of U.S. exports in 1988, is the largest cigarette export market for U.S. producers. Other important markets in 1988 included Japan (23 percent), Hong Kong (13 percent), and Saudi Arabia (5 percent).

Diversion of trade to the U.S. market.—Since U.S. cigarettes are estimated to account for about 30 percent of the EC market and trade sources indicate that EC production makes up most of the remainder, it is unlikely that any significant diversion of cigarette trade would take place. In addition, U.S. consumption of cigarettes consists almost exclusively of domestic production (imports accounted for less than .05 percent of U.S. cigarette consumption in 1988) and would not likely increase, even if third-country cigarettes were displaced from the EC market, because of U.S. consumers' brand loyalty, taste preferences, and the marketing abilities of the large U.S. manufacturers.

U.S. investment and operating conditions in the EC.—Assuming that these proposed directives are adopted, U.S. investment and operating conditions relating to manufactured-tobacco products in the EC would likely be adversely affected. It is estimated (from U.S. Department of Commerce data) that U.S. direct investment in the manufactured tobacco industry in the EC was about $2 billion in 1988. Trade sources report that the majority of this investment is in the cigarette industry and that this is the industry that would probably be most adversely impacted. A discriminatory ad valorem tax (the U.S. product is generally higher priced than similar competing products) could result in the U.S. product suffering significant price and margin disadvantages, and as a result, U.S. investment and operating conditions in the EC would probably be adversely impacted. Industry sources have indicated that because of the substantial investment by U.S. manufacturers in EC manufacturing facilities, any impact would have to be assessed in light of overall operating conditions within the EC rather than as it may affect trade between the United States and the EC. The ad valorem tax may have an adverse effect on future investment in the EC by U.S. producers of manufactured tobacco products, since it would discriminate against higher valued products and U.S. products tend to be higher valued.

U.S. industry response

The U.S. tobacco industry, through its trade association, has expressed its dissatisfaction with both proposals to various agencies of the U.S. Government. Industry contacts have indicated no specific industry actions that are likely to be taken in response to the directives.

Views of interested parties

Comments received from the tobacco industry are as follows:

(1) It is opposed to both proposals in their present form since they will not achieve their stated objectives of creating a free-trading market within the 12 member states of the EC.

(2) The industry believes that a free market can only be created in excise goods such as manufactured tobacco products if the excise tax structure is entirely specific (e.g., francs per carton, as opposed ad valorem), as in the United States.

(3) Ad valorem excise taxes, as contained in the proposals, will require a complex collection

method that will prevent free movement of the goods between member states.

(4) The economic and competitive effect of ad valorem excise causes typical U.S.-type tobacco products to suffer severe price and margin disadvantages versus, particularly, the mainstream products of state tobacco monopolies in France, Italy, Spain and Portugal (these markets represent approximately 50 percent of EC cigarette consumption).

(5) Pure specific excise, meaning the abolition of the ad valorem excise element (but not VAT), would create normal competitive conditions for the products of U.S. companies operating in the EC as well as permit the completion of the integrated market within the EC.

Withholding Tax on Interest Income—Proposed Directive for a Common System

The White Paper identified the liberalization of financial services, linked to that of capital movements, as a major necessary step towards EC financial integration and the widening of the internal market.[61] Measures being taken in that direction are described in the financial sector chapter of this report. Article 6(5) of Council directive (88) 361 of June 24, 1988, on the liberalization of capital movements required the EC Commission to submit to the Council proposals aimed at eliminating or reducing risks of distortion, tax evasion, and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems. A proposed directive was issued by the EC Commission in January 1989. However, the measure reportedly is opposed by the United Kingdom, Luxembourg, and West Germany[62] and is considered "dead."[63] At its meeting in Madrid in late June 1989, the European Council asked the Council of Ministers to find a "satisfactory solution" to the problems of taxation of savings in order to reach an agreement before July 1, 1990.[64] On July 10, 1989, the EC Commission presented EC finance ministers with a five-track strategy to address the matter.

The communication from the EC Commission issued with the January proposal stated that the proposed directive (and a second proposed directive relating to mutual assistance by the competent authorities of the member states in the field of direct taxation and VAT[65]) was "not intended to bring about complete harmonization of the taxation of savings, something which is neither necessary nor desirable at the moment," but rather was "designed primarily to deal with the increased risks of avoidance or evasion which will be a direct result of the final phase of the liberalization of capital movements," which will allow EC residents the freedom to transfer their savings into bank accounts in any other member state.[66] The communication stated that although the risk could not be quantified with any degree of accuracy, the evidence from West Germany following the introduction of a 10-percent withholding tax, from the Netherlands (following the introduction of an automatic obligation on banks to declare interest), and from France (in the Lebegue report) suggested the loss of tax revenues from nondeclaration of interest income could be substantial.[67]

The proposal contains seven principal features:[68]

(1) There should be a minimum rate of withholding tax of 15 percent paid by debtors residing in the EC. Member states would be free to apply a higher rate either to their own domestic taxpapers only or to all recipients of interest. The communication noted that the 15-percent rate was close to the average of the withholding taxes applied in the EC (0 to 35 percent).

(2) Member states that already have a system of automatic declaration to the tax authorities of interest payments by banks would be permitted to apply the withholding tax only to residents of the other member states.

(3) Member states would be free to not apply the withholding tax to tax-exempt savings income (savings books and other forms of small savings).

(4) Member states would have the option of not applying the withholding tax to interest payments constituting industrial or commercial income.

(5) Member states would also have the option of not applying the withholding tax to interest payments made to residents of third countries or to international loans such as Eurobonds. The communication noted that interest on Eurobonds is not subject to withholding tax in most member states and expressed the concern that if it were, European firms might be placed at a disadvantage relative to U.S. and Japanese firms or that EC issuers would set up subsidiaries in third countries to float their bonds and thereby escape tax.

[61] White Paper, par. 101, p. 27.
[62] See, e.g., "May in the EEC: Finance," *The Economist* (June 3, 1989), p. 54.
[63] Nigel Lawson, British Chancellor of the Exchequer, as quoted in Buchan, "Brussels outlines proposals to beat tax-dodgers," *Financial Times*, July 11, 1989, p. 2.
[64] Conclusions of the Madrid European Council, June 26 to 27, 1989.
[65] Proposal for a Council directive amending directive 77/799/EEC concerning mutual assistance by the competent authorities of the member states in the field of direct taxation and value-added tax, included in COM(89) 60 final/3, May 12, 1989.
[66] COM(89) 60 final/3, p. 3.
[67] Ibid. Germany introduced its 10-percent withholding tax in January 1989 and repealed it in April.
[68] See, in particular, the communication, pp. 7 to 9.

(6) The withholding tax would be levied by the debtor or the debtor's paying agent in the case of interest-bearing financial instruments, including bank accounts.

(7) Member states would have the option of either regarding the withholding tax as fully extinguishing their resident taxpapers' liability to tax or of considering it as a payment on account of personal income tax, in which case the tax paid would be credited against the total amount of tax payable by the taxpayer, with the excess being refunded when appropriate.

The July 10 paper to the finance ministers makes only "passing reference" to the minimum 15-percent tax-rate.[69] Instead, the new proposals call for (1) tax authorities and financial institutions like banks to more systematically remind taxpapers and clients of their fiscal responsibilities; (2) reinforced cooperation between member-state national authorities in suspected cases of fraud; (3) new citizen reporting requirements relating to exports of significant amounts of capital; (4) ratification by all member states of a 1959 Council of Europe convention relating to judicial cooperation in the event of suspected large-scale fraud linked to crime of drug trafficking and (5) renewed bilateral discussions with the United States, Japan, and EFTA countries and within OECD for better international tax cooperation.[70]

[69] *Financial Times*, July 11, 1989, p.2.
[70] Ibid. The paper was presented by Christine Scrivener, the European tax commissioner. Chancellor of the Exchequer Nigel Lawson was quoted in the article as stating that the new proposal indicated "that the Community is now on the more productive line of how we can reinforce fiscal cooperation to minimise fraud."

Harmonization of Direct Taxes

There have been numerous studies over the years on the question of direct tax harmonization. However, the Treaty of Rome contains no obligation to harmonize direct taxes. As a result, EC Commission initiatives involving direct taxes have been brought under the legal aegis of article 100, which calls for the approximation of laws.[71] Effective rates of tax on capital vary widely across the EC as a result of differences in nominal company tax rates, the definition of tax base, the provision of various tax and other fiscal incentives, and personal income and wealth taxes. Some argue that the EC would be better served if it were to allow competitive market forces to lead the way towards a convergence of tax systems. They believe that there is a "serious danger that imposed harmonization could effectively create a tax collectors' cartel, perpetuating high rates and antiquated structures."[72] In the absence of imposed harmonization, some believe that higher corporate tax countries like Germany may be forced to lower corporate income tax rates so that local firms will not be forced to operate at a competitive disadvantage in comparison with firms in other member states.[73]

[71] J. Chown, *Company Tax Harmonisation in the EEC*, unpublished monograph (1989), app. 2, "History of Initiatives Taken," p. 1.
[72] Chown, p. 4.
[73] Testimony of Lother Griessbach, representative for German Industry and Trade, on behalf of the Association of German Chambers of Industry and Commerce, Washington, DC, at USITC hearing Apr. 11, 1989, p. 63.

CHAPTER 11
RESIDUAL QUANTITATIVE RESTRICTIONS

CONTENTS

Chapter 11

Residual Quantitative Restrictions

Introduction

The elimination of intraborder controls in the EC's effort to create a single internal market will pressure the EC to transform existing or residual national quantitative restrictions (QRs) into EC-wide quotas or other protective measures, particularly in sensitive sectors. Although new EC-wide quotas are likely to be directed at Asian exporters rather than exports from the United States, new EC barriers could intensify trade-diversionary effects, increase competition facing U.S. exporters in certain member-state markets, or increase competition for U.S. subsidiaries already located in the EC.

Background

Article 113 of the Treaty of Rome granted the EC Commission exclusive competence to develop a common commercial policy for the EC towards the rest of the world. However, despite the formal requirement for member states to pursue a uniform commercial policy, most member countries continue to impose national QRs. Over 1,000 QRs are currently maintained by individual member countries. These quotas or grey-area measures (usually voluntary restraint agreements) are aimed primarily at state-trading nations and Asian exporters and cover a wide variety of products, including, in particular, textiles and automobiles. The majority of the remaining QRs are on products that are not viewed as significant to world trading interests, such as silver-plated spoons.

Many of the national QRs that exist today were already maintained by member states at the time they acceded to the EC and were grandfathered following accession. Others are linked directly to agreements concluded by the EC Commission, such as the Multifiber Arrangement (MFA) and the Generalized System of Preferences (GSP). Currently, those member countries with the largest number of residual quotas are Italy, France, and Spain. Unlike most of the quotas, which cover textiles and apparel, Spanish QRs cover a large number of agricultural as well as industrial goods.[1]

Effective enforcement of these national restrictions is safeguarded by article 115 of the Treaty of Rome. Article 115 allows member countries to prevent circumvention of their quotas otherwise possible through the transshipment of the restricted product through other member nations that do not maintain quotas. Article 115's provisions are intended to prevent deflection of goods among the member countries caused by both disparities in member-state quotas and by rare occasions of tariff differences between new EC members and the rest of the EC. If trade deflection has occurred or a member state is experiencing economic difficulties caused by disparities between measures of commercial policy, that country may apply under article 115 to the EC Commission for authorization to introduce either protective measures or intra-EC surveillance measures (permitting the use of import licenses) to monitor the flow of indirect imports. Border controls between the member states are currently charged with collecting the statistical data on trade flows necessary to support a country's claim for assistance under article 115.

The basic EC rules governing the imposition of QRs with respect to imports from third countries are found in the three regulations on common rules on imports: regulation Nos. 288/82, 1765/82, and 1766/82. Regulation No. 1765/82 covers products originating in state-trading nations and regulation No. 1766/82 is applicable to trade with the People's Republic of China.[2] Regulation No. 288/82 applies to trade with all other third countries except textiles products covered by specific common import rules (such as the MFA) and Cuba. This regulation allows member states to retain QRs with respect to third countries for products "not yet liberalized at Community level," i.e., for products still subject to national QRs. Annex 1 of regulation No. 288/82 contains an exhaustive list of all of the QRs maintained by member states covered by the regulation. This list is regularly updated by the EC Commission, usually once a year.[3]

Anticipated Changes

The status of national QRs after 1992 is currently unclear. Although these quotas are sanctioned by the Treaty of Rome, they will be inconsistent with the integrated single market because the EC intends to eliminate all border controls. Therefore, the prevailing view is that allowing the current situation to continue past 1992 is not an option. Although there are

[1] Many of the QRs currently imposed by Spain and Portugal are scheduled to be phased out by 1992 and 1993, respectively. Spain and Portugal joined the EC on Jan. 1, 1986, and consequently, their trading regimes are in a transitional phase that provides time for the countries to adapt to EC rules. Portugal's program to abolish QRs was brought forward to Jan. 1, 1988, with the elimination of a significant number of QRs. Furthermore, U.S. Government consultations with Spain during 1988 addressed most U.S. concerns over Spanish QRs. See Office of the United States Trade Representative, *1989 National Trade Estimate Report on Foreign Trade Barriers*, pp. 155, 156.

[2] Reference should also be made to regulation No. 3420/83 that is applicable to trade with the countries covered by regulations Nos. 1765/82 and 1766/82.

[3] See for example, Ivo Van Bael and Jean Francois Bellis, *International Trade Law and Practice of the European Community*, (London: CCH Editions Ltd, 1985) pp. 164 to 166, or E.L.M. Volker, ed., *Protectionism and the European Community*, (New York: Kluwer Law and Taxation Publishers, 1987) pp. 34 to 37.

alternative options to pursue, the White Paper is somewhat ambivalent about which option might be adopted:

> ". . . until the powers transferred by the Treaty to the Community are fully exercised and the common commercial policy has been strengthened in such a way that all national protection measures and all regional quotas set up by the Community can be abolished, there will be a continuing need for some form of control. The Commission takes the view that it is not an unreasonable aim to achieve this abolition of national and regional quotas by 1992. . . . Should it prove impossible to eliminate all individual quotas for Member States by 1992, internal frontier controls could no longer be the instrument of their application. Alternative ways of applying quotas would need to be found."

Since the White Paper was adopted, the EC Commission has indicated more definitively how it plans to address the issue of residual QRs:

> "Once frontier posts have been removed, bilateral quotas on imports of sensitive products between individual Member States and third countries, and limits for individual Member States within the Community's quotas under textile agreements and the Generalized System of Preferences, will no longer be workable within the single market. In some cases, the restrictions will simply be eliminated (with Community assistance to restructure sensitive sectors where necessary). In other cases, national protective measures may have to be replaced by appropriate measures at the Community level."[4]

Therefore, the options facing the EC appear to be threefold: first, to unilaterally abandon existing national restrictions; second, to transform existing national restrictions into EC-wide quotas; and third, to replace current national restrictions with other EC measures, including possibly increased reliance on antidumping statutes, subsidization of sensitive industries, or higher tariffs. The choice of new EC measures would be constrained by international commitments, such as the "standstill" agreement concluded in the Uruguay Round, or GATT rules governing tariff rates.[5] Furthermore, in September 1988, the European Court of Justice ruled that EC tariff quotas applied under the scheme of generalized tariff preferences may not be apportioned between the member states. Although this ruling was an action separate from the 1992 exercise, it may have repercussions on the EC's choice of options.[6]

[4] Commission of the European Communities, "Europe-World Partner, Questions and Answers," Oct. 19, 1988.
[5] For a discussion of GATT provisions governing tariff rates, see pt. III of this report.
[6] USITC staff meeting with a member of the U.S. Mission to the European Community (USEC) on Feb. 28, 1989. See also case 51/87: Commission of the European Communities v. Council of the European Communities, Sept. 27, 1988.

Ongoing EC Actions that Address QRs

Certain groups of QRs are currently being addressed by the EC Commission. For example, the EC Commission intends to address national quotas with state-trading nations on an individual-country basis. In fact, the EC and Hungary recently ratified an agreement on economic cooperation that calls for the elimination of all national QRs on imports from Hungary in three phases, to be completed by December 31, 1995.[7] A special safeguard provision in this agreement allows the EC to limit imports under certain circumstances. Several other Eastern bloc nations are also negotiating economic cooperation agreements with the EC, depending on their GATT status and their political system. These agreements are expected to liberalize national quotas rather than completely eliminate them.[8]

The status of preferential quotas with the African, Caribbean, and Pacific states (ACP) under the Lome Convention is still unclear, although ACP suppliers have expressed concern that their privileged positions on the EC market must be safeguarded. Traditional ACP suppliers of bananas, which account for 20 percent of EC banana consumption, have been particularly vocal. Consequently, EC officials have reaffirmed their "good intentions" and pledged in principle to consult with ACP countries when developing a common regime for bananas.[9]

Another group of QRs is currently being addressed within the GATT. On March 8, 1988, the EC circulated a proposal to roll back certain national QRs to the GATT Uruguay Round Standstill and Rollback Surveillance Body. This offer to remove some 90 to 100 QRs is estimated to cover actual trade of $675 million a year and to apply to a wide range of products, such as gilt spoons and jute sacks. However, the proposal was made contingent on rollback commitments by other countries.[10] Moreover, some delegations

[7] "Proposal for a Council Decision on the conclusion of an agreement on trade and commercial and economic cooperation between the European Economic Community and the Hungarian People's Republic," COM (88) 568 final, Brussels, Oct. 12, 1988.
[8] USITC staff meeting with a member of USEC on Mar. 1, 1989. The EC and Czechoslovakia have signed but not ratified an agreement that would eliminate quantitative restrictions on some products, and suspend the application of quotas on other products. See "Agreement between the European Economic Community and the Czechoslovak Socialist Republic on trade in industrial products," *Official Journal of the European Communities (O.J.)* (Oct. 1, 1988) No. C 7/5 19. Negotiations with Poland and Bulgaria should begin soon. Negotiations with East Germany and the Soviet Union will follow. For political reasons, negotiations with Romania are not anticipated.
[9] "EEC/Dominica/St Lucia: Coming to the aid of Caribbean bananas," *European Report* (Mar. 11, 1989) p. V-1.
[10] "GATT Focus," April/May 1988, p. 8. Also, see pt. III section of this report on Uruguay Round Initiatives.

expressed concern over the partial nature of the rollback, which eliminates global quotas but at the same time excludes certain countries from the liberalization exercise, thereby introducing discrimination. According to Japan, some of whose products are excluded, the EC's rollback offer would actually increase the number of Japanese items subject to national QRs from 131 to 134.[11]

Japan's irritation over this result contributed to its decision to threaten action in the GATT to demand removal of all of the national quotas directed at Japan.[12] Concerned that dispute-settlement procedures under the GATT would turn in Japan's favor, the EC agreed in June 1988 to conduct informal consultations with Japan to resolve the issue. The first round of talks in September ended without a definitive agreement. The second round of informal consultations took place from February 9 to March 17, 1989. The EC Commission persuaded individual member states to lift 41 of the quotas, but the Japanese remained dissatisfied since member countries refused to lift QRs on key Japanese exports, such as automobiles, motorcycles with engines of 380 cc or less, sewing machines, and electronics products.[13] Further talks resulted in an EC Commission offer to abolish about 68 QRs, to resume talks in December 1989 on the remaining quotas, and to consult informally with Japan on an annual basis thereafter. In return, the Japanese agreed that as long as reasonable progress is made, Japan would abandon its threat to bring the issue before the GATT.[14]

Identification of Sensitive Sectors

The EC Commission has not yet identified those sectors that would require an EC-wide quota, with the exception of automobiles. In 1987, Karl-Heinz Narjes, EC Industry Commissioner, said that national restraints on Japanese imports could be phased out "provided that Japan's exports [of autos] to the whole of the EC are stabilized during the period of transition up to 1992 and perhaps for a short period following."[15] In late 1988, the EC Commission agreed in principle to negotiate with the Japanese "to stabilize Japanese imports to the Community until 1992 and moderate them for a limited period afterwards, while allowing some growth of imports."[16]

The EC Commission has indicated that other sensitive sectors may also require EC-wide measures. In a document released in October 1988, the EC Commission stated that shoes and consumer electronics would require an EC-wide approach.[17] The EC Commission also identified 12 sectors that are under member-state restrictions and that have trade problems that are not EC-wide in dimension.[18] According to the EC Commission, those sensitive sectors that face economic difficulties in only a limited region may not warrant EC-wide quotas but rather, another solution, such as subsidies. Four sectors are still under study, and four other sectors—footwear, urea, autos, and bananas—are being actively discussed to determine a specific solution to their trade problems.[19] An EC official also indicated that the EC intends to secure a promise from its trading partners not to disrupt their markets through sudden increases in imports. "We'll be asking for more discipline in export management, probably a special clause that will commit foreign exporters to maintain traditional trade flows and avoid sudden export surges on national markets."[20]

Conclusion

In general, U.S. officials expect that the EC will choose to replace current member-state quotas with an increased reliance on trade policy measures, such as antidumping cases.[21] However, the United States Trade Representative (USTR) announced at a March 20 hearing before the House Ways and Means Committee's trade subcommittee that it expects national QRs on five products to be extended EC-wide after 1992. These five products include automobiles, consumer electronics, footwear, urea, and bananas.

The EC Commission has reaffirmed "that its target in implementing the White Paper is to abolish formalities at intra-Community frontiers, including the use of Article 115, by 31 December 1992."[22] It is possible, however, that a safeguards measure will be retained for application under

[11] "EEC/Japan: Bilateral Meeting on 131 Import Quotas," *European Report*, (Jan. 17, 1989) p. V-4.
[12] In March 1988, Japan tabled a request for rollback consultations with the EC on the 156 QRs maintained by the member states against Japan.
[13] "EEC/Japan: Community offer on quotas seen as insufficient by Japan," *European Report* (Feb. 13, 1989) p. V-3.
[14] "EEC/Japan: Breakthrough on Import Quotas," *European Report* (Mar. 22, 1989) p. V-1.
[15] Commission of the European Communities, "The Future of the European Automobile Industry," press release, Nov. 25, 1987, p. 3.
[16] "Cars: EEC To Ask Japan to Stabilize Car Exports Between Now and 1992," *European Report* (Nov. 10, 1988) p. IV-7.
[17] Commission of the European Communities, "La Dimension Exterieure du Marche Unique, Annexe III, Regime a l'importation article 115 du Traite CEE: etat des travaux," SEC(88) 1493/2, Oct. 18, 1988.
[18] These 12 products are toys; gloves; cartridges; float glass; objects of glass; umbrellas; brooms; brushes; motors; tires, tubes and hoses; measuring instruments; and roller bearings.
[19] The four sectors under study are sewing machines, motorcycles, dishware, and ceramic articles.
[20] "1992, Getting into Europe," *South*, December 1988, p. 11.
[21] USITC staff meeting with a member of USEC, Feb. 28, 1989.
[22] Commission of the European Communities, written question No. 179/86, June 30, 1986.

certain circumstances. For example, a safeguard mechanism may be justified if external tariffs differ between a new member country of the EC and established member states.[23] Also, safeguard measures may be necessary to ensure that quotas negotiated with ACP countries under the Lome Convention—if they are retained—are fulfilled.[24] Further, trade between West Germany and East Germany is not subject to tariffs or other import restrictions because trade between the two Germanys is considered internal trade. How the potential leakage of goods into the rest of the EC will be treated after 1992 is unknown.[25] Finally, temporary import protection measures could be introduced post-1992 should member states suffer adjustment problems as a result of trade liberalization.[26]

Possible Effects

Since internal borders will be eliminated, post-1992 QRs would have to be made EC-wide to be effective. The EC Commission has suggested that EC-wide restrictions might be adopted for certain "sensitive" industries. However, the EC Commission has not specified any particular product areas to date. Based on conversations with and/or articles written by U.S. industry, Government, and trade sources, the USITC has pinpointed three product areas for which some form of QR already exists in an EC country, which are likely to be "sensitive" areas for the EC. It is possible that EC-wide restrictions could be put in place in 1992 on autos, footwear, and textiles and apparel.[27] It is assumed that these restrictions will be placed on products produced in Asian countries, primarily Japan, Taiwan and Korea, and will not be applied to direct U.S. exports. A discussion of import restrictions on steel is also presented, given the importance of this industry to some of the world's major trading partners—the EC, the United States, and Japan.

U.S. Exports to the EC

U.S. exports of automobiles to the EC rose more than eightfold, from $69 million in 1984 to $575 million in 1988. QRs on EC imports of automobiles would probably be directed primarily at Japan, which could provide increased marketing opportunities in the EC for U.S. automakers. If the EC institutes local-content requirements on automobiles, Japanese-owned automakers in the United States could face barriers in exporting to the EC.

U.S. exports of footwear totaled $186 million in 1987, a third of which went to the EC. There are no restrictions on imports of U.S. footwear into any of the EC member states. Italy is the major U.S. market in the EC, accounting for 50 percent of U.S. footwear exports to the EC. Imports into Italy from Korea and Taiwan are limited by a VRA. Similarly, these two Far Eastern suppliers limit exports to France, which accounts for about 15 percent of U.S. footwear exports to the EC. One effect of an EC-wide quota on Far Eastern footwear exports could be increased imports into these two EC countries. The new quota could be greater than the sum of the current VRAs to take into account trade with other member states. In addition, there would not be any member-state subquotas; thus, exporters would have the option to ship the entire quota amount to one member state. U.S. exporters could thus face increased competition in Italy and France if Far Eastern suppliers increase shipments to these countries.

Similarly as with footwear, Far Eastern textile and apparel exporters would face a single EC-wide quota by product, without subquotas for the individual member states. Therefore, the entire quota could be shipped into a single country. The current quota system may force some of the controlled exporters to divert trade from countries where these exporters have the greatest competitive advantage, but where they are limited by a quota, to a less restricted market. Since individual EC-country markets may become more accessible, trade patterns may shift. Thus, even though U.S. exports to the EC are not subject to quota, U.S. exporters could be subject to increased competition from third-country exporters in certain markets as the trade patterns are realigned. In 1988, U.S. exports of textiles and apparel to the EC were valued at $1 billion.

The United States accounted for 1.5 percent of total EC imports of steel in 1988. The EC's QRs on steel imports do not apply to the United States and likely changes in this regime will affect only Eastern bloc countries. Consequently, EC integration is not expected to significantly affect U.S. steel exports.

Diversion of trade to the U.S. market

Some trade diversion in terms of increased exports being diverted to the United States is anticipated in two of the four products—footwear, and textiles and apparel. The EC has been a growing market for imported footwear. If this growth is limited by QRs, foreign suppliers would

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[23] Francis Sarre, "Article 115 EEC Treaty and Trade with Eastern Europe," *Intereconomics*, (September/October 1988), pp. 233 to 240.
[24] Ibid.
[25] Michael Calingaert, *The 1992 Challenge From Europe: Development of the European Community's Internal Market* (Washington, DC: National Planning Association, [1988]), p. 73.
[26] Wilhelm Nolling, "The Impact of 1992 on European Integration and Relations with the United States," *Intereconomics* (November/December 1988) p. 259.
[27] Other reports have labeled as "sensitive" additional products, such as consumer electronics, urea, and bananas. However, USITC staff could not suggest at this time, within reasonable doubt, product areas other than automobiles, textiles and apparel, footwear, and steel that the EC Commission might determine to be "sensitive."

be likely to increase shipments to non-EC markets such as the United States. The diversion to the United States could be limited by the fact that the import-penetration ratio in the U.S. footwear industry is already 70 percent. The possible amount of textile and apparel trade that could be diverted from the EC would be limited because the United States already controls these imports from the major exporting countries. In addition, any significant increase in uncontrolled U.S. textile and apparel imports could become subject to restraint.

In automobiles, non-EC firms that face QRs on their exports may turn to increased investment in production facilities within the EC. Therefore, the more significant effect may be in investment patterns.

In steel, member states may remove quotas with five Eastern bloc countries. However, VRAs currently limit exports from four of these nations to the United States and the fifth country is not a significant supplier to the U.S. market.

U.S. Investment and Operating Conditions in the EC

U.S. investment in the EC in footwear, textiles and apparel, and steel is currently limited and is not expected to increase as a result of the Internal Market exercise. However, U.S. subsidiaries producing automobiles in the EC are planning to increase investment to meet the increased competition. Ford Motor Co., for example, is planning to spend $7.5 billion in Europe over 5 years to maintain its position.

Industry Analysis

This ends the general discussion of quantitative restrictions. The remainder of the chapter examines the impact of potential quantitative restrictions on the following industries:

Automobiles
Footwear
Textiles and apparel
Steel

The reader should see the chapter table of contents for the specific page locations of the above analyses that are of interest.

Automobiles

Current restraints

Under article 115 of the Treaty of Rome, EC countries were able to establish limits on imports of automobiles from Japan. In 1988, Japan's informal voluntary export restraint of automobiles into the EC was 1.21 million cars.[28] Italy's quota, which has been approved by the GATT, limits imports of Japanese autos to 2,500 cars, amounting to less than 1 percent of its market. The United Kingdom has an industry-to-industry VRA that limits imports of Japanese autos to approximately 11 percent of its market.[29] France's quota on Japanese imports is less than 3 percent of total sales, representing approximately 18,000 units in 1988.[30] Portugal and Spain also have bilateral controls on imports of autos produced in Japan.[31] The Japanese Ministry for International Trade and Industry announced on April 5, 1989, that it would continue monitoring exports to Europe for another fiscal year and increase exports by no more than 3 percent.[32]

Anticipated changes

The EC seeks to establish a uniform internal market for automobiles and a common foreign-trade policy. During the period 1977 to 1987, total automobile imports in Japan amounted to 560,000 units, and total EC imports of automobiles amounted to 12 million cars, of which 8.2 million automobiles were imported from Japan.[33] The EC seeks to stabilize imports from Japan into the EC until 1992 and moderate imports thereafter. The EC is also seeking to open the Japanese market to EC automobiles in order that the EC may gain an appropriate share of the Japanese market.[34]

Although certain EC countries (e.g., West Germany and the United Kingdom) oppose external quotas on automobile imports,[35] other member countries, particularly France and Italy, argue for a transitional period to allow EC automobile producers to become more competitive.[36] France and Italy have urged that during this period, QRs on imports of automobiles produced in Japan should remain in effect and local-content requirements should be established

[28] USITC staff meeting with representatives of the Society of Motor Manufacturers and Traders, London, England, Apr. 24, 1989.

[29] Werner P. Schmidt, Volkswagen AG, Wolfsburg, West Germany, "Points Relating to the Discussion Topic, 'The Pacific Region and Europe, 1992,'" Sydney, Australia, May 1989.

[30] General Agreement on Tariffs and Trade, "Developments in the Trading System, October 1987 to March 1988," p. 195.

[31] Ibid., p. 196.

[32] Stefan Wagstyl, "Japan to extend curbs on car exports to EC," *Financial Times*, Apr. 6, 1989, p. 6.

[33] "The Automobile Sector: A Competitive European Industry at World Level," Fiat Auto Co., paper presented at European Parliament conference, *A Strong Europe—A Competitive Industry*, Mar. 7, 1989, p. 4.

[34] Communication of Mr. K. H. Narjes in accordance with Lord Cockfield, Mr. De Clercq, Mr. Sutherland, "The Competitiveness of the European Motor Industry in the Light of 1992."

[35] USITC staff meetings with British Government officials, London, England, Apr. 24, 1989, and with Volkswagen officials, Wolfsburg, West Germany, May 10, 1989.

[36] Cesare Romiti, paper presented at European Parliament conference, *A Strong Europe—A Competitive Industry*, Mar. 7, 1989, p. 10 and EC Commission, *The Future of the European Automobile Industry* (Brussels [Nov. 25, 1987]).

for Japanese-owned automobile plants operating in the EC.[37] Discussions between EC and Japanese officials regarding these issues have remained informal and confidential.[38] Consequently, it is not known to what extent imports and local content will be regulated by the EC.

Industry sources report that Japan may voluntarily restrict its exports to approximately 11 percent of the EC automobile market during a transitional period.[39] The nature of local-content requirements is less certain. There is widespread opposition in the EC to what are referred to as "screwdriver plants"; that is, assembly operations with limited utilization of EC-produced parts.[40] There is no official EC local-content level that qualifies automobiles as EC-produced, although in past EC disputes involving this issue, 60-percent EC content has been used as a guideline.[41] Nevertheless, 80- and 90-percent local content levels have also been proposed. For example, during 1988, the French Government threatened to count imports of the British-produced Nissan Bluebird as an import from Japan because these automobiles had 70- rather than 80-percent EC content. France later agreed to classify these automobiles as British produced, but the general issue remains unresolved. The United Kingdom also favors an 80 percent local-content restriction, but argues that foreign-owned firms should have a transitional period in which to reach that level.[42]

Certain EC automobile trade officials have stated that local content requirements are unlikely to be established.[43] These officials argue that the rule of origin (which states that a product is considered to have originated in the country where the last substantial transformation of the product occurred, [Article 5 of the 802/68 EC regulation]), applies to the production of automobiles.[44] Under this rule, local content is largely irrelevant, and Japanese-owned assembly plants in the EC would not likely be the subject of disputes relating to the country of origin issue.

[37] "The Automotive Sector: A Competitive European Industry at World Level," p. 14.
[38] Karin Bogart, "Toward a unified auto policy", *Tokyo Business Today*, (February 1989), pp. 56 to 57.
[39] USITC staff meeting with members of Fiat Auto, Turin, Italy, May 3, 1989.
[40] EC Commission, *The Future of the European Automobile Industry* (Brussels [November 1987]).
[41] Hanns R. Glatz, "The Local Content Issue in the EC," presentation at the Society of Automotive Engineers Conference, Washington, DC, May 1989.
[42] Kevin Done, "Car makers dispute local content," *Financial Times*, (Feb. 27, 1989), p. 4 and Glatz, "The Local Content Issue in the EC," 1989.
[43] USITC staff meeting with a member of the Committee Liaison of Automobile Constructors, Brussels, Belgium, May 8, 1989.
[44] EC Commission, "A Competitive Assessment of the European Automotive Industry in View of 1992," (Brussels [October 1988]).

Possible effects

U.S. exports to the EC.—If automobile quotas are phased out without being replaced by other EC measures, industry sources state that both sales of Japanese automobiles and the market share of automobiles held by Japan would increase. There would be a concurrent loss of automobile sales by EC producers according to a study by Marketing Systems, in West Germany.[45]

U.S. automakers would be likely to face increased competition in the EC.[46] However, U.S. exporters would probably benefit from their reputation in producing quality cars. A recent J.D. Power and Associates survey of auto purchasers in North America indicates that, although Japanese products are currently regarded as being superior in quality, U.S. product quality is improving rapidly. According to the auto purchasers surveyed, the product quality of automobiles produced in Europe ranks third behind that of Japanese and U.S. automobiles. A unified market would benefit North American auto exporters that have learned to offer a variety of car models with wide ranges of technology and design.[47]

If the EC were to impose an EC-wide quota on imports of Japanese automobiles during a transitional period, U.S. automakers could face increased marketing opportunities for their exports in the EC. On the other hand, if the EC institutes local-content requirements that affect Japanese-owned automobile plants in both the EC and other nations, Japanese-owned automakers in the United States could face barriers in exporting to the EC. U.S. transplant operations generally obtain from Japan over 20 percent of the parts used in their products. An 80-percent local-content requirement by the EC would qualify automobiles produced in transplants as Japanese-made products, and exports to the EC would count towards any export restraints against Japan.[48] However, the issue of local-content requirements directed toward Japanese-based auto manufacturers in both the EC and the United States is highly debated and has not yet been resolved by the EC Commission.

During 1984–88 U.S. exports to the EC rose more than eightfold, from $69 million in 1984 to $575 million in 1988. West Germany, France, and Belgium were the largest EC-country markets during the period, together accounting for 78 percent of total U.S. exports to the EC in 1988.

The EC accounted for 7 percent of total U.S.

[45] Ibid.
[46] USITC staff meeting with members of Ford Motor Co., Brussels, Belgium, May 8, 1989.
[47] Ibid.
[48] Prepared statement of John F. Krafcik, Research Associate, International Motor Vehicle Program, MIT, before the Subcommittee on Europe and the Middle East and Subcommittee of International Economic Policy and Trade Committee on Foreign Affairs, U.S. House of Representatives, Washington, DC, on Mar. 24, 1989.

exports of motor vehicles (SITC ch. 78[49]) in 1988 according to official U.S. Department of Commerce data, as shown in the following tabulation (in million of dollars):

Market	U.S. exports
EC	575
Japan	319
Canada	6,305
World	8,791

The United States accounted for 25 percent of total EC imports of motor vehicles (SITC ch. 78[49]) in 1988 according to official U.S. Department of Commerce data, as shown in the following tabulation (in percent):

Source	EC imports
United States	25
Japan	2
Canada	2

Diversion of trade to the U.S. market.—It is unlikely that trade diversion to the United States would occur should EC-wide QRs on imports of automobiles from Japan be imposed during a transition period. Since substantial production capacity exists globally, automobile-producing countries could export to the United States regardless of whether or not third countries impose import barriers.

The Japanese are shifting production facilities to the EC in anticipation of increased EC restrictions on imports of Japanese automobiles. Japanese automakers' capacity to produce vehicles in the EC, as a percent of total vehicle EC production capacity, rose from 0 percent in 1980 to 1.0 percent in 1985 and is expected to double to 2.1 percent by 1990. Mazda Motor Corp. and Ford Motor Co. plan a joint venture to build cars at a Ford Europe plant, and Toyota Motor Corp. plans to assemble autos at a Regie Renault facility. Mitsubishi Motors Corp. hopes for an assembly deal with Daimler-Benz AG. Fuji Heavy Industries would like to establish a plant in France, solely or in a joint venture with a French partner to handle stamping and assembly. Nissan already has production facilities in the United Kingdom. Isuzu Motors Ltd. plans to build light trucks through its British commercial-vehicle partnership with General Motors Corp. General Motors will sell the truck in Europe beginning in 1990. In addition, Toyota, Honda, Daihatsu, and Hino currently have manufacturing bases in Europe or are poised for a buildup.[50]

Japan's capacity to produce vehicles in the United States, as a percent of total U.S. vehicle production capacity, rose from 0 percent in 1980 to 3.1 percent in 1985, and is forecast to more than triple to 10.8 percent by 1990. Honda of America Manufacturing Inc., opened an automobile assembly plant in Ohio in 1982 and announced intentions to start up a second auto assembly plant in Ohio in 1990. Nissan Motor Manufacturing Corp., U.S.A., began producing trucks and cars in Tennessee in 1983. Mazda Motor Manufacturing U.S.A. Corp began assembly of cars in Michigan in 1987. Toyota Motor Manufacturing U.S.A. began car production in Kentucky in 1988, and plans to open a truck assembly plant in the near future. Toyota and General Motors have a joint venture in California; Chrysler Corp. and Mitsubishi Motor Corp. began joint-venture production of cars in 1988; and Fuji Heavy Industries and Isuzu will jointly produce cars and trucks in Indiana in 1989.

U.S. investment and operating conditions in the EC.—To preserve market share, U.S. automakers are increasing investment in facilities in the EC. Ford Motor Co. has sales of $17 billion, profit of $1 billion, and is planning to spend $7.5 billion in Europe over 5 years to maintain its position. Ford has manufacturing facilities in six European countries and has 22 plants in Europe, overall.[51] General Motors has six vehicle-assembly plants in Europe and 19 component-manufacturing operations there. GM's Automotive Components Group has established a specific European organization to coordinate GM's component activities in Europe and between Europe and the United States. GM also has a European Systems Engineering Center in Europe.[52] U.S. Department of Commerce officials forecast that the 1992 EC market integration will lead to greater U.S. investment in the EC in the future.

U.S. industry response

U.S. automakers have stated that the EC 1992 integration is likely to provide them with the opportunity to expand sales in some of the more protected countries, like Spain, Italy, France, and Portugal. The reduction of "national champions" will allow for increased competition in the home markets. This increased competition will lead to the expansion beyond the home countries in search of new, competitive markets.[53]

[49] SITC ch. 78 includes road vehicles (including air-cushion vehicles).
[50] "Carmakers Wary over EC Local Content Debate," *The Japan Economic Journal* (Dec. 3, 1988), p. 5. Professor Garel Rhys, "The Motor Industry in the UK," paper presented at *The Motor Agents Association National Conference 1988*, p. 7.

[51] USITC staff meeting with members of Ford Motor Co., Brussels, Belgium, May 8, 1989, and various Ford Motor Co. annual reports.
[52] General Motors Corp., correspondence with USITC, Feb. 8, 1989, p. 2.
[53] USITC staff meeting with members of General Motors Corp., Bonn, West Germany, Apr. 27, 1989.

Views of interested parties

A U.S. association of import dealers stated that should automobiles produced in the United States by Japan be included in the anticipated EC quota on Japanese cars, the United States would be expected to retaliate against European cars imported into the United States, and the U.S. import dealers association would use legislation in the recently enacted Trade Act to seek relief. The same association stated that U.S. auto manufacturers operating in the EC are supportive of restrictions on Japanese imports into the EC and would benefit from such restraints.[54]

The international union, the United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW) endorses the European Trade Union Council (ETUC) social program for 1992 that aims to protect high national standards for working conditions in the EC automotive industry. The UAW also states that Japan's voluntary export restraint of automobiles should remain in effect, as it is the basis for development of a long-term strategy for a healthy U.S. automotive industry.[55]

The United States Council for International Business expressed concern that the EC may adopt rules-of-origin requirements with high levels of local content, which may impact on U.S. exports of automobiles produced by Japanese manufacturers. The U.S. Council states that the only appropriate solution is for the EC to eliminate all QRs maintained by member states.[56]

Footwear

Current restraints

The EC does not limit imports of footwear from the United States. Currently, Italy and France have each negotiated their own VRAs restricting Taiwan and Korean imports of most categories of footwear. However, imports into Italy and France account for only about one-third of total EC footwear imports from Taiwan and Korea.

Anticipated changes

It is anticipated that these VRAs would be expanded into EC-wide quotas, without sublimits limiting imports into individual EC member countries.

[54] "Newsletter," American International Automobile Dealers Association, Nov. 28, 1988.
[55] Statement of the international union, United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW), submitted to the USITC, Apr. 26, 1989.
[56] Statement of the United States Council for International Business, submitted to the U.S. International Trade Commission Apr. 25, 1989.

Possible effects

U.S. exports to the EC.—Because the current VRAs only cover about one-third of all EC footwear imports, it is uncertain at what level the EC-wide quotas would be set. In 1987, EC imports of footwear from Taiwan and Korea totaled about $950 million, with France and Italy accounting for about $320 million. Extending the quotas to the EC as a whole with no subquotas on imports into individual member countries could lead to two possible results. If the EC quota levels are set at roughly the current level of total EC imports from these countries, it would be expected that Taiwan and Korea would shift their exports towards France and Italy and away from the other EC countries. It is expected that if the EC quota levels are set at levels above the current imports into France and Italy from Korea and Taiwan but significantly below the EC import levels from these countries there will be a significant decline in footwear imports by the EC countries other than France and Italy. It is also possible that there could be a slight decline in French and Italian imports as these goods are diverted to other parts of the EC.

U.S. exports of footwear totaled only $186 million, or about 5 percent of total production. The EC as a whole accounted for about 37 percent of total U.S. footwear exports (SITC ch. 85) in 1988 according to United Nations trade data, as shown in the following tabulation (in millions of dollars):

Market	*U.S. exports*
EC	88
Japan	49
Canada	20
World	242

Italy accounted for roughly 50 percent of the EC total and France, about 15 percent. Consequently, the direction of trade shifts within the EC could significantly alter the impact on U.S. footwear exports.

If Italy and France gain imports from the Far Eastern suppliers as a result of extending the footwear quotas, it is probable that these imports would displace a significant amount of U.S. exports. Although this would also create some new markets in the other EC countries, market-share analysis indicates that the U.S. industry would be able to increase shipments to these markets only slightly. If the level of EC-wide footwear quotas results in decreased Italian and French imports from Taiwan and Korea, it is possible that the United States could increase its EC exports to fill this new market.

The United States accounted for 1 percent of total EC imports of footwear (SITC ch. 85) in 1988 according to United Nations trade data, as

shown in the following tabulation (in percent):

Source	EC imports
United States	1
Japan	(1)
Canada	(1)
Other	99

[1] Less than 0.5 percent.

Diversion of trade to the U.S. market.—It is expected that there would be a significant amount of trade diversion, both to the United States and to third countries, as a result of extension of the footwear quotas EC-wide. This is particularly true if the EC-wide quota levels are significantly below the current levels of EC imports. All of the EC imports that would be thus restricted would probably be diverted to such developed countries as the United States and Japan. Diversion to Japan, the United States' second-largest export market, would be likely to result in a decline in U.S. exports to that country.

Although it is expected that there would be less diversion if limits were set at approximately the current level of EC imports, trade diversion is still likely to be a significant factor. EC imports of footwear more than doubled between 1985 and 1987, with large-percentage growth of imports by all EC countries. This trend would be likely to continue in the absence of quota restraints. If such restraints are put into effect, the anticipated shipments to the EC by Taiwan and Korea would be likely to be diverted to the United States and Japan. Although less than if EC imports were cut in nominal terms, the amount of trade diversion would cause a significant negative impact on the U.S. footwear industry. However, trade diversion to the United States could be limited by the fact that the import-penetration ratio in the U.S. footwear industry is already around 70 percent. It is possible that Taiwan and Korea have already saturated the market because of their large production capacity and no further penetration would be possible, even if their access to the EC market were further limited.

U.S. investment and operating conditions in the EC.—Although data are not available on investment by the U.S. industry in EC countries, such investments are believed to be minimal. In fact, total U.S. investment in the EC for the leather-product and rubber-product industries combined amounts to less than $1 billion. Given the fact that the U.S. footwear industry has lost a large percentage of its domestic market share, it is not expected that the industry would seek to expand its overseas investments.

U.S. industry response

The U.S. industry has not yet focused strongly on the issue of EC integration.

Views of interested parties

No formal submissions were received.

Textiles and Apparel

Current restraints

The EC does not impose QRs on imports of textiles and apparel from the United States. QRs on textile and apparel imports take any of three different forms. The most common restrictions are fairly comprehensive bilateral agreements negotiated between the EC and 22 textile-exporting countries under the MFA. In general, under the agreements, individual quotas are established regulating imports into each of the EC-member countries. The EC has also negotiated VRAs dealing with textiles and apparel with eight Mediterranean countries (Cyprus, Egypt, Malta, Morocco, Tunisia, Turkey, Spain, and Portugal).[57] With the exception of Turkey, these agreements tend to be more limited in product coverage and do not encompass all of the member states. Many of these VRAs also restrict outward processing. Thirdly, some member states themselves place import restraints on imports of textiles and apparel from state-trading countries, including Albania, Bulgaria, China, Czechoslovakia, East Germany, Hungary, Mongolia, North Korea, Poland, Romania, the Soviet Union, and Vietnam. The EC already has bilaterals with some of these exporting countries under the MFA, and these additional restrictions by the member states are placed primarily on outward processing of textiles and apparel. In all, there are some kind of quantitative restraints on the imports of textiles and apparel into EC-member countries from 36 different countries.

Anticipated changes

If all EC countries have quota restraints, then a single EC-level quota, by product, could be established that would simply be equal to the sum of all of the current individual-country quotas for that product. For products that are under restraint in only some member states, it is anticipated that these quotas would be replaced with a system of EC-wide quotas. In both cases, there would be no individual subquotas further regulating trade by EC member states.[58]

Possible effects

U.S. exports to the EC.—U.S. exports and EC imports of textiles and apparel are summarized in tables 11-1 and 11-2.

In the aggregate, the anticipated changes in the EC quota system should be neither trade

[57] The VRAs with Spain and Portugal are currently being phased out, resulting from their accession into the EC. These agreements are set to expire at the end of 1989.
[58] For example, see "Textiles: Commission Sews Up Its Report," *European Report* (Nov. 25, 1988) pp. V-9 to 11.

Table 11-1
Textiles and apparel: U.S. exports, 1988

(In millions of dollars)

SITC chapter	EC	Japan	Canada	World	Ratio of EC/world
65[1]	838	244	665	3,650	23
84[2]	197	161	61	1,610	12

[1] Textile yarn, fabric, made up articles.
[2] Articles of apparel and clothing.

Source: United Nations trade data.

Table 11-2
Textiles and apparel: EC imports, 1988

(In percent)

SITC chapter	United States	Japan	Canada	Other	Ratio of EC/world
65[1]	7	4	0	89	7
84[2]	1	1	0	98	1

[1] Textile yarn, fabric, made up articles.
[2] Articles of apparel and clothing.

Source: United Nations trade data.

creating nor significantly more trade restricting. However, there could be important shifts in the trade patterns. As individual-country quotas are eliminated, it could be expected that imports from restricted countries would shift away from those EC countries in which their competitive advantage is marginal and towards those where their competitive advantage is greatest. However, since U.S. exports of textiles and apparel to the EC are not restricted, this would not directly impact the United States.

The EC has classified its quota categories on the basis of their estimated level of sensitivity to imports. There are eight categories, consisting of cotton yarns, cotton fabrics, manmade-fiber spun-yarn fabrics, T-shirts, jerseys, trousers, blouses, and shirts, which are given the highest rating of "ultrasensitive." These products are likely to be impacted most by any changes in the quota system and, therefore, will act as the framework for this analysis.

The individual-country subquotas tend to reflect the pre-quota level of imports of the specific product from the particular country involved. Thus, it can be assumed that those importing countries with the highest quota levels will be those in which the exporting country has the greatest competitive advantage for that particular product. By aggregating the ultra-sensitive categories, it can be determined which EC countries are at the greatest competitive disadvantage as compared with the restricted exporters, and therefore would be expected to absorb a greater proportion of EC imports once the country subquotas are removed.

For the aggregate of the ultrasensitive textile categories, Germany has 25 percent of the allocated quota; followed by Italy, with 24 percent; the United Kingdom, with 21 percent; the Benelux countries, with 13 percent; and France, with 10 percent. Therefore, controlled textile imports under an EC-wide quota would be likely to flow more toward the first three countries listed above. It is expected that these imports would displace both domestic production and uncontrolled imports, primarily from the developed countries. On the other hand, the other countries that would be likely to see a decline in their controlled imports of textiles would be able to replace these either with domestic goods or with uncontrolled imports.

It is estimated that U.S. exports of textile products account for only about 5 percent of U.S. production. The largest export markets for the United States are Canada and Mexico, representing about 20 percent and 10 percent, respectively. As a whole the EC represents about 23 percent of U.S. exports of textiles. The largest EC markets for U.S. textiles are the Benelux countries, the United Kingdom, and Germany.

Because of the projected trade shifts, it is likely that the United States would lose a significant amount of its textile exports to Germany, Italy, and the United Kingdom. However, the United States would have the potential to gain significant textile exports to France and the Benelux countries. By using market-share analysis, the extent to which the U.S. industry would supply the new unfulfilled demand in these countries can be estimated. For the textile industry, market-share analysis indicates that the U.S. industry is significantly more competitive than that of France or the Benelux countries. Therefore, it can be estimated that U.S. textile exports would increase to these countries as a result of the anticipated changes in the EC textile and apparel quota system.

The United States exports very little apparel, with the bulk of it being traded under Harmonized Tariff Schedule subheading 9802.00.80 (old TSUS item 807.00) with Mexico and the Caribbean. The EC accounts for only about 12 percent of U.S. apparel exports. The largest EC markets for the United States are the Benelux countries, Italy, France, the United Kingdom, and Germany.

For the ultrasensitive apparel categories, Germany has 38 percent of the allocated quota, followed by the United Kingdom, with 24 percent; France, with 12 percent; the Benelux countries, with 11 percent; and Italy, with 7 percent. Therefore, controlled apparel exports would be likely to flow more toward Germany and the United Kingdom under an EC-wide quota system.

The potential new markets for the U.S. apparel industry would appear to be in France, Italy, and the Benelux countries if EC-wide quotas were established. However, market-share analysis indicates that the U.S. apparel industry is less competitive than the French and Italian industries. Consequently, increased exports of apparel could only be expected to occur in the Benelux countries. The projected increase would probably be overshadowed in the aggregate by the expected loss of exports to Germany and the United Kingdom resulting from increased developing-country imports. Therefore, it is anticipated that U.S. exports of apparel to the EC as a whole would decline slightly as a result of the anticipated changes in the EC textile and apparel quota system.

Diversion of trade to the U.S. market.—Trade diversion could only occur if the alterations in the EC's textile and apparel quota system were to be trade restrictive against third countries. Under the anticipated new system, trade restrictions would occur against countries whose exports are not restricted in all EC countries. All of the major suppliers that are covered by import restrictions have extensive agreements encompassing all the EC countries. Trade restriction would occur only against smaller world suppliers and only in less important categories. Consequently, the possible amount of trade diversion would be limited. In addition, if a significant amount of trade diversion were to occur, the United States would be able to place limits on such imports.

U.S. investment and operating conditions in the EC.—In recent years, the large U.S. textile companies have been removing their investments from the EC as part of their efforts to rationalize their production. Apparel companies have yet to invest heavily in the EC. As a result, total investment in the EC by U.S. textile and apparel companies was less than $600 million in 1987. The trade shifts would suggest that U.S. firms have opportunities for new investments in the Benelux countries and in France for the textile industry and in France, the Benelux countries, and Italy for the apparel industry. However, it is not expected that the new openings in these markets will be sufficient to counteract the current trend toward disinvestment in the EC. On the other hand, the changes in the quota system increasing developing-country imports of textiles into Germany, Italy, and the United Kingdom and developing-country imports of apparel into Germany and the United Kingdom would be likely to hasten the removal of investments in these countries. The net result is likely to be decreased investment in the EC by U.S. textile and apparel companies.

U.S. industry response

There are currently no indications as to the precise nature of the changes in the EC textile and apparel quota system. Although it would seem that the removal of all country subquotas would be the only system consistent with the objectives of EC integration, U.S. industry sources are skeptical that this will occur. As a result, the industry has not yet focused heavily on the issue.

Views of interested parties

No formal submissions were received.

Steel

Current restraints

An EC-wide system of import restrictions on steel was implemented by the EC Commission in 1978 and is renewed on an annual basis.[59] Prior to 1978, the EC Commission did not administer a comprehensive system of import protection in steel, although a variety of protective policies of individual member states, including national QRs on imports, were in existence.[60]

The current system of import-control measures is largely based on Commission-negotiated voluntary restraint agreements with most of the principal exporters to the EC market, covering about 75 percent of EC steel imports.

[59] The EC currently has agreements with Austria, Finland, Norway, Sweden, Brazil, Bulgaria, Czechoslovakia, Hungary, Poland, Romania, South Korea, and Venezuela. Previously concluded VRAs with Japan, Canada, South Africa, and Australia were not renegotiated as these countries did not fill their quotas in 1988. Commission Recommendation, *O.J.*, (Nov. 19, 1987), p. 25, and telephone conversation with the staff of the Delegation of the Commission of the European Communities, Washington, DC, June 1989.

[60] Thomas R. Howell, William A. Noellert, Jensen G. Kreier, and Alan Wm. Wolff, *Steel and the State: Government Intervention and Steel's Structural Crisis*, (Boulder and London Westview Press) p. 94. The subject book contains a comprehensive treatment of the operation of the European Community's system of steel import restrictions, along with citations of official documents, both on which this discussion of the restrictions is largely based.

The United States, which exports relatively insignificant levels of steel to the EC, is not a signatory to these agreements.

The EC Commission currently observes a free trade agreement with European Free Trade Association (EFTA) countries[61] wherein established consultation procedures are followed when traditional supply patterns are violated; no explicit quotas are established. Bilateral agreements with other exporting countries usually entail consultative procedures and a mix of import price and volume restraints established by the EC Commission. In return for compliance with EC-wide quotas, price restraints, and consultation procedures, these bilateral agreements allow signatory nations to maintain distribution of their exports regionally within the EC according to "traditional patterns of trade," except in the case of Eastern bloc signatories,[62] which must also observe some individual member-state quotas. Exporting countries with no agreement are expected to observe minimum import prices (trigger prices) based on the EC Commission's calculation of the production costs of the world's most efficient producers. [63]

The agreements also require signatories to abide by a so-called "triple clause," which states that imports should be spread out over the year, throughout the EC, and across the product range. This is intended to limit the exporter from exporting to only one market, exporting only one product, or exporting in a concentrated time period.

Import prices, which must be stated on import licenses, are independently monitored by EC member states;[64] import prices that fall below established minimum prices are reported to the EC Commission, which then initiates consultations. EC-wide quotas are essentially self-monitored by the EC's foreign suppliers based on "traditional" trade, although it appears that the EC does confirm approximate compliance through the compilation and analysis of import licenses. Member-state quotas with Eastern bloc suppliers are monitored by member states. When either type of quota (EC-wide or member state) is violated, the EC Commission initiates consultations. In the event of continued violations, the dumped or subsidized product could be excluded from the agreement or the agreement could be terminated and antidumping and countervailing duty cases initiated.

[61] Austria, Finland, Norway, and Sweden.
[62] Bulgaria, Czechoslovakia, Hungary, Poland, and Romania.
[63] Telephone conversation with staff of the Delegation of the Commission of the European Communities, Washington, DC, June 1989.
[64] *O. J.*, (Nov. 19, 1987), p. 23; and Commission Decision, *O. J.*, (Jan. 1, 1989), p. 24.

Anticipated changes

Although there are indications that some members of the EC Commission favor termination of the steel VRAs,[65] the staff of the EC delegation presently anticipates no change in the manner in which EC Commission agreements are negotiated and implemented as a result of EC integration. The existing member-state quotas with Eastern bloc countries, however, would probably be eliminated or modified to an EC-wide quota to conform with the removal of member-state QRs consistent with an integrated market.[66]

Possible effects

U.S. exports to the EC.—EC integration is not expected to create or restrict steel trade between the United States and the EC. The EC's present program of quantitative restraints does apply to the United States, and likely changes in the program will affect only Eastern bloc countries. Comments recently made by the director general of the European Confederation of Iron and Steel Industries reinforce the anticipated limited effect of the EC 1992 Program on steel trade.[67] In 1988, U.S. steel exports to the EC accounted for 15.4 percent of total steel exports and less than 1 percent of all U.S. steel industry shipments. The following tabulation shows U.S. exports of steel (SITC ch. 67[68]) to the EC during 1988 based on statistical tables provided by the OECD[69](in millions of tonnes):

Market	*U.S. exports*
EC	0.2
Japan	0.1
Canada	0.5
World	1.3

The United States accounted for 1.5 percent of total EC imports of steel in 1988. The following tabulation shows EC imports of steel (SITC ch. 67[70]) during 1988 based on OECD statistics[71] (in millions of tonnes):

[65] Speech by Martin Bangemann, EC Commission Vice President, to the 56th World Congress of the Iron Industry, in Dusseldorf, West Germany, on May 22, 1989.
[66] Telephone conversation with staff of the Delegation of the Commission of the European Communities, Washington, DC, June 1989.
[67] *American Metal Market* (May 23, 1989), p.1.
[68] SITC ch. 67 includes all steel mill shapes.
[69] Organization for Economic Cooperation and Development, *Draft Report on the Steel Market in 1988 and the Outlook for 1989: Statistical Tables*, (Apr. 11, 1989), p. 10.
[70] SITC ch. 67 includes all steel mill shapes.
[71] Organization for Economic Cooperation and Development, *Draft Report on the Steel Market in 1988 and the Outlook for 1989: Statistical Tables*, Apr. 11, 1989, p. 10.

Source	EC imports
United States	0.2
Japan	0.3
Canada	0.1
World	13.7

Diversion of trade to the U.S. market.—As a result of EC integration, no diversion of exports to the United States is expected to occur. The likely removal of the few individual member-state quotas will affect only five Eastern bloc countries, four of which are presently covered by U.S. VRAs. The fifth, Bulgaria, is not a significant supplier to the United States. Nine of the 12 signatories to the EC VRAs are also signatories to the U.S. VRAs. In addition, the EC's restraints have apparently been liberalized in recent years; rails and semifinished steel have been eliminated from the EC's restraints and EC-wide quotas for eight countries with volume restraints were increased by 3 percent in 1989. A number of countries failed to fill their quotas in 1988.

Unanticipated alterations in the EC Commission's operation of the steel import restraint program stemming from EC integration, and adjustments in the U.S.-VRA program in steel could lead to shifts in trading patterns in the U.S. market; however, current information suggests that the effect of EC 1992 integration is likely to be limited.

U.S. investment and operating conditions in the EC.—U.S. steel industry investment in the EC appears to be insignificant. The continuation of the EC's quantitative restraints should neither encourage nor deter U.S. investment in the EC.

U.S. industry responses

No response from the U.S. steel industry is anticipated.

Views of interested parties

No formal submissions were received.

CHAPTER 12
INTELLECTUAL PROPERTY

CONTENTS

Chapter 12

Intellectual Property

(Directives 87/54, 89/104, Proposed Directives (84)/470,(85)/844, (86)/731, (88)/172, and (88)/496)

Background

The issue of intellectual property rights in the EC is an important one for the United States. The products of many U.S. firms sold in the EC are or can be protected by some intellectual property right. Such rights are especially important for firms selling high-technology products such as biotechnology and computer software, because of the considerable investment often required to develop such products (e.g., biotechnology) and/or the ease of copying such products (e.g., computer software).

Most of the 12 member states of the EC have well-developed intellectual-property laws. All are members of the World Intellectual Property Organization. All are signatories to the Paris Convention (1967 revision), the Universal Copyright Convention (various forms), and the Berne Convention. These are the three major substantive multilateral agreements on intellectual property, to which the United States is also signatory.

Within the EC, a Community Patent Convention has been proposed, but has yet to enter into force. Several of the member states (along with several non-member states) are signatory to the European Patent Convention, a multilateral system that permits a single application to be filed with the European Patent Office and that results in the grant of what is essentially a bundle of national patents.

With the advent of the 1992 program, the EC is in the process of establishing EC-wide regimes and/or partial harmonizations of national law on intellectual property. The impetus for this effort is the conclusion in the White Paper that differences in intellectual-property laws among the member states of the EC have a direct and negative impact on intra-EC trade and on the ability of enterprises to treat the common market as a single environment for their economic activities.

Semiconductor Mask Works

Background

"Mask works" are a unique form of intellectual property first recognized by the United States in the Semiconductor Chip Protection Act of 1984, Public Law 98-620, Chapter 9 of title 17, United States Code (SCPA). Protection under the SCPA extends to the three-dimensional images or patterns formed on or in the layers of metallic, insulating, or semiconductor material and fixed in a semiconductor chip product, i.e., the "topography" of the "chip." The type of protection afforded by the SCPA is somewhat similar to that provided by the Copyright Act, and both statutes are administered by the Copyright Office. However, the two types of protection differ from each other in many respects, including eligibility, ownership, term, scope and limitation of rights, remedies, and registration procedures.

The reciprocity/national-treatment provisions of the SCPA were intended to stimulate other countries to enact similar legislation and extend it to U.S. nationals. This intent has been realized, as several countries have enacted or are in the process of enacting such legislation. As discussed below, these countries include all the member states of the EC. In addition, negotiations have recently been concluded under the auspices of the World Intellectual Property Organization (WIPO) on a new, multilateral treaty for the protection of mask works. The member states of the EC and the United States are members of WIPO and participated in the negotiations. The United States, however, did not find that treaty acceptable and did not sign it.

Anticipated Changes

Council directive 87/54 was adopted on December 16, 1986, and was published in the *Official Journal* on January 27, 1987. It directs the member states to enact laws for the protection of topographies of semiconductor products ("mask works"). These laws must conform to minimum standards set forth in the directive.

Member states must, among other things, provide for the exclusive right to reproduce the topography, to commercially exploit it, or to import for commercial exploitation the topography or a semiconductor product made by using it. Certain exceptions are provided for.

Member states may make registration and/or deposit a prerequisite for protection. Generally, the term of protection is 10 years.

There was no previous EC law on semiconductor topographies, though a few member states provided some protection under their own national copyright laws. All member states have complied with or are complying with this directive.

To assure that U.S. mask works are protected in the EC while national laws protecting mask works are finalized, the EC Council adopted a decision on October 26, 1987, obligating the member states to extend protection under the directive to U.S. nationals and domiciliaries until November 7, 1990.[1] This protection is based on

[1] *Council Decision of 26 October 1987, 87/532/EEC, Official Journal of the European Communities (O.J.) No. L313,* (Nov. 4, 1987), p. 22.

continued U.S. protection of mask works produced in the EC.

The EC eventually expects to request a Presidential proclamation conferring permanent protection under section 902(a)(2) of the SCPA as soon as all laws are final. At present, EC mask works are protected under interim orders issued pursuant to section 914 of the SCPA. Section 914 gives the Secretary of Commerce authority to issue orders extending interim protection to foreign mask work owners upon the satisfaction of certain conditions. First, the Secretary must find that the foreign nation is making good-faith efforts and reasonable progress toward entering into a treaty with the United States or that the foreign government is in the process of enacting legislation that will protect U.S. mask works on the same basis as domestic mask works or a level similar to that provided under the SCPA. Second, the Secretary must determine that nationals, domiciliaries and sovereign authorities of the foreign nation are not engaged in the misappropriation, or unauthorized distribution or commercial exploitation, of mask works. Finally, the Secretary must determine that issuance of an interim order would promote the purposes of the SCPA and international comity with respect to the protection of mask works.

These interim orders for the member states of the EC (and several other countries as well) have recently been extended to October 31, 1989.

Possible Effects

Directive 87/54 should provide increased market opportunities in the EC for U.S. semiconductor firms. U.S. semiconductor firms are innovative and have accounted for all major advances in semiconductor technology, including the discovery of the transistor, the dynamic random access memory (DRAM), and the erasable programmable read only memory (EPROM). Patent violations and copying of products developed by U.S. firms have become widespread by foreign firms, particularly by those in the Far East. This has been a pervasive practice because most countries do not recognize semiconductor masks as articles eligible for registration under the provisions of their copyright laws. In addition, a general definition of reverse engineering between countries has not been universally agreed upon.

U.S. Exports to the EC

The EC provides the largest foreign market for U.S. semiconductor products, and U.S. firms have made large investments in semiconductor wafer fabrication plants in Western Europe. The EC historically has maintained high tariffs on imports of semiconductors, although the EC uses a tariff procedure that waives the duty on imported products of a type not produced in the EC. The high tariffs have in part served as an incentive to U.S. firms to make local investments in the EC, whereas firms in the Far East have frequently been able to compete with U.S. firms for market share in the EC by copying U.S.-produced semiconductors and thus avoiding the costs of research and development. As such, the effect on U.S. exports of semiconductors to the EC will probably be relatively small and secondary to the effects on U.S. investment.

U.S. exports to the EC rose from $577 million in 1984 to $898 million in 1988, representing an increase of 56 percent. The United Kingdom, West Germany, and France were the largest EC-country markets during the period, together accounting for 82 percent of total U.S. exports to the EC in 1988.

Diversion of trade to the U.S. market

The adoption of directive 87/54 by the EC is likely to have no effect on the U.S. market for semiconductors. The United States has already adopted similar legislation under the Semiconductor Chip Protection Act of 1984. It is more likely that U.S. semiconductor firms will encounter trade diversion in third-country markets where central governments either have not adopted similar legislation, or where the practice of reverse engineering is encouraged.

U.S. investment and operating conditions in the EC

The United States has more than $2 billion invested in semiconductor operations in the EC and U.S. firms account for more than 40 percent of the European market either through local production or through exports. The large U.S. investment in Western Europe was encouraged through policies adopted by Western European governments who realized early in the 1970s that semiconductor technology was important to the growth of their end-product industries.

Recently, the EC announced a change in its country-of-origin rules regarding semiconductors. Under these new rules (unlike the practice followed in the United States), integrated circuits that are wire bonded, encapsulated, and tested in the EC and containing chips produced in other countries will no longer be considered an EC product. Previously, the EC used the final significant transformation of the product (encapsulation) to determine the country of origin of a semiconductor. The implication of this rule change is that U.S. and foreign firms that only have "back-end" operations in the EC may have to invest heavily in wafer-fabrication facilities in the EC in order to remain competitive in that market. The protection provided by the directive will facilitate such investment.

U.S. Industry Response

U.S. firms have consistently advocated that the United States enter into an international treaty for the protection of semiconductor technologies and other intellectual property provided that there is special emphasis on compulsory licensing, reverse engineering, and provisions for dispute settlement. U.S. firms have also advocated that before the United States signs any such treaty, written assurances should be received that the treaty is enforceable. The United States pioneered the protection of semiconductor topographies, and since the Semiconductor Chip Protection Act of 1984 was enacted, that act has brought about the rapid enactment of similar laws in foreign countries. The act provides protection for semiconductor topographies of foreign semiconductor designs, if foreign countries provide similar protection for U.S. semiconductor topographies.

Views of Interested Parties

No formal submissions were received.

Trademarks

Background

Most of the member states of the EC have well developed and generally similar trademark laws. The member states have sought harmonization by creating a European Community trademark regime parallel to the existing national regimes and by seeking partial harmonization among the national regimes.

Anticipated Changes

Council directive 89/104 was adopted on December 21, 1988, and published in the *Official Journal* on February 11, 1989. It is intended to approximate the member-state laws relating to trademarks. It is not a full-scale harmonization. The directive relates only to trademarks acquired by registration and is intended to complement the proposed Regulation on the Community Trade Mark. The approximation aims to require that the conditions for obtaining and maintaining trademark rights are, in general, identical and to ensure their uniform protection. To this end, the proposed directive sets out minimum substantive standards for refusing registration, for the exclusive rights to be obtained on registration, for use, and for invalidation. The procedure for registration and invalidation and the effect of invalidation would be governed by national law.

All member states have trademark laws that will have to be amended in some degree to conform with this directive.

Proposed regulation 84/470 would, if adopted, establish an EC-wide regime for trademarks. Enforcement of a "Community trade mark" (CTM) would be in the national courts.

CTM rights, like the national trademark regimes of the member states, would generally be acquired by registration with the proposed Community Trade Marks Office. Guarantee and collective marks could also be registered. Registration would be refused if the trademark is not distinctive, is unlawful, or is not available. Registrations would be for 10 years, renewable for 10-year periods.

There are extensive procedural provisions governing proceedings before the Community Trade Marks Office. An appeal may be taken from decisions of the office to a board of appeal and from there to the Court of Justice.

Persons who would be able to own a CTM include nationals of member states, nationals of states that are parties to the Paris Convention, nationals of other states who are domiciled in or who have establishments in the European Community or Paris Convention states or in states that accord national treatment for trademarks for all member states.

No member state would be required to amend its laws if this proposed regulation were adopted.

Proposed regulation 85/844 would implement the proposed Regulation on the Community Trade Mark. The proposed regulation would, among other things, specify the formalities for applying for a CTM, the calculation and laying down of the time limits to be observed in dealings with the Community Trade Marks Office, the items to be published in the *Community Trade Marks Bulletin,* and the rules governing opposition, appeals, revocation, and invalidity procedures.

No member state would be required to amend its laws if this proposed regulation were adopted.

Proposed regulation 86/731 would set rules of procedure for the board of appeals, which is to be established by the proposed regulation on the CTM. The proposed rules are based on those for the European Patent Office. The essential points addressed by the proposed rules are the distribution of work among the boards of appeal, procedural organization within the boards of appeal, a rapporteur who would summarize the factual and legal problems for the parties, provisional decisions, and oral hearings.

No member state would be required to change its laws if this proposed regulation were adopted.

Possible Effects

Although the EC countries have good trademark protection in general, certain countries, including Greece, Italy, Spain, and Portugal, are perceived by many U.S. industries as offering less than completely adequate protection. The creation of a CTM (proposal

(84)/470, along with (85)/844 and (86)/731) will simplify the acquisition of trademark protection by non-EC suppliers, in addition to enhancing the average protection, and presumably enforcement, EC-wide. This change will allow action to discourage counterfeiting and other trademark violations, thus promoting greater sales of legitimate goods, both domestic and foreign. Similarly, the approximation of the trademark laws of the member states (directive 89/104) can be expected to enhance protection. The harmonization should simplify the acquisition of trademarks by ensuring that registration and protection is handled in a similar manner by all member states. However, it would still be necessary to deal with each member state individually. This directive may be viewed as complementary to the EC-wide trademark system embodied in proposal (84)/470.

U.S. exports to the EC

Although U.S. exporters will enjoy no special advantages per se, U.S. firms own a proportionately large share of internationally well-known trademarks and should benefit accordingly. Those industries relying to a great extent on trademarks, particularly consumer goods, pharmaceuticals, and agricultural chemicals, should benefit to the greatest degree.

The overall benefit is expected to be moderate at best, because trademark protection is already very good in the EC as a whole, and losses due to violations of trademark rights in the EC are on the low end of the scale internationally. The provisions of the adopted directive and proposed regulations are not discriminatory; assuming adequate and fair enforcement, the net effect will be positive.

Diversion of trade to the U.S. Market

Imports from suppliers of counterfeits and other infringing goods could conceivably be diverted as a result of the enforcement of uniform EC trademarks. Although some of these types of goods could be diverted to the United States and escape Customs to enter the U.S. market, the trade would most likely be diverted to third-country markets.

U.S. investment

The effect of an adequately enforced EC trademark would be to protect and encourage U.S. investment. It should act to encourage future U.S. investment in the EC because trademark protection will be uniformly available and enforced EC-wide. It will positively affect business operating conditions by simplifying the acquisition and enforcement of trademark rights and by enhancing protection in some of the member countries. In this regard, an EC mark would be far more beneficial in reducing the administrative and enforcement burden than would a simple harmonization of the various laws of the member states.

U.S. Industry Response

An EC trademark or uniformly administered harmonized member-state trademarks reportedly will allow U.S. industries to eliminate inadequate trademark protection as a factor in deciding which member state markets to exploit as a market or for purposes of investment.

Views of Interested Parties

The National Association of Manufacturers submitted a copy of its February 1989 report, entitled *EC 92 and U.S. Industry* (hereinafter "NAM Report"). The NAM Report states that U.S. companies may benefit from the proposed Regulation on the Community Trade Mark, but notes that the current proposals may have some disadvantages, such as a cumbersome search procedure.

The United States Council for International Business submitted a copy of its document reflecting positions it has taken, entitled *Statement of the United States Council for International Business on the European Single Market* (hereinafter "USCIB Statement"). The USCIB Statement expresses full support of the EC's trademark directive and proposals, including the proposed regulation on the Community Trade Mark. On specific points in the proposed regulation, it notes that it has argued, among other things, that infringement claims should be pursued through an EC trademark court.

Copyright

Background

Most of the member states of the EC have well-developed copyright laws. The 1992 program with respect to copyrights consists of a so-called "Green Paper" and a proposed directive on computer programs.

Anticipated Changes

Green Paper 88/172 was submitted to the Council by the EC Commission on June 7, 1988. It is entitled "Green Paper On Copyright And The Challenges Of Technology—Copyright Issues Requiring Immediate Action." It is a consultative document for which comment by interested parties is sought. The topics discussed are limited to piracy, home copying of sound and audiovisual works, distribution and rental rights for sound and video recordings, computer programs, data bases, and external aspects of copyright protection. It is not a proposed directive or regulation but contains suggested courses of action and may result in future action by the EC and/or its member states. Some of these suggested courses of action are quite detailed, as in the case of piracy. One area, on computer

programs, is part of the 1992 program and is the subject of a proposed directive but is not within the purview of this study since it was not formally proposed until after December 31, 1988.

Possible Effects

Assuming that a directive results from the Green Paper on Copyrights ((88)/172), the harmonization and strengthening of the member states' copyright laws, particularly with respect to audio and video recordings, will reduce piracy within the EC and increase the market for legitimate products regardless of origin. According to U.S. and EC industry sources, because U.S. firms account for a proportionately high percentage of the EC markets for a number of products relying on copyright protection, they currently lose more than most other non-EC suppliers to piracy, and could be expected to gain more from improved copyright protection and enforcement.

U.S. exports to the EC

Exporters and holders of copyrights on recorded videocassettes and audio recordings could be expected to benefit to the greatest degree. Other beneficiaries would include the publishing and computer software industries. In addition, any other industry that relies to a significant extent on copyright protection, such as the character licensing and toy industries, would also benefit to some extent.

Assuming that adequate enforcement would accompany the harmonization of copyright protection, the benefit to U.S. industries would be significant. The following tabulation, derived from estimates provided in the Green Paper and estimates provided to the United States Trade Representative by industry associations, shows annual pirated videocassette sales as a share of the total market, by member country (in percent):

Market	*Pirate sales estimated by the EC*	*Pirate sales estimated by the U.S. Industry*
Belgium and Luxembourg	25	25
Denmark	5 to 10	(1)
Greece	50	(1)
Spain	30	55
France	25	25
Ireland	30	40
Italy	40	50
Netherlands	40 to 45	45
Portugal	70 to 75	80
United Kingdom	under 20	(1)
West Germany	45	(1)

[1] Not available.

U.S. industry sources have estimated that U.S. firms sustain the following annual losses due to videocassette piracy: Spain—$25 million, France—$10 million to $18 million, Italy—$15 million, Portugal—$10 million to $25 million, the United Kingdom—$10 million, and West Germany—$15 million. Estimates are not available for the remaining member countries but may be assumed to be of the same order of magnitude. In addition, the Recording Industry Association of America estimates that pirated audio records and tapes in Spain result in U.S. losses of $32 million annually.

Realistically, not all of these losses could be eliminated even given the best of copyright protection, but an adequately enforced common copyright protection scheme could significantly reduce these losses.

Copyright violations on published works are rarer, primarily because the potential profit is far lower, and copyright protection of software is fairly good in the EC as a whole, so the effects on these industries would be less significant, as would the benefits to other copyright-dependent industries.

The only potentially discriminatory result of a directive covering the issues raised in the Green Paper would be in the area of levies to compensate copyrightholders for copying of audiotapes or videotapes. The development of digital audio tape (DAT) technology allows for unlimited audiotape copying without loss of quality. The paper recommends a technical or physical protection as part of the recording equipment or the tapes that would prevent or limit the copying capability. Unfortunately, most of these schemes reduce the sound reproduction quality, thus at least partially eliminating DAT's advantage over standard analog tape recorders. In addition, there are no protective devices on analog recorders, and, although quality deteriorates through each generation of analog copying, enough copies of an acceptable quality can be made on this equipment to continue to pose a problem until DAT eventually takes over the market. An alternative is to levy a fee on blank audiotapes and videotapes and the recording equipment to be distributed to copyrightholders in partial recompense for the inevitable home copying. Certain members already have these fees—West Germany levies the fees on both tape and equipment; France, on tape alone. In both cases the levies are nondiscriminatory, applying equally to imports and domestic goods.

Even in the unlikely event that a levy that discriminated against imports were enacted, the United States would not be especially hard hit because it is not a leading supplier of either recording equipment or blank tape of this type.

Trade data on specific products and industries most likely to require copyright protection are not available. However, U.S. exports to the EC of prepared media for sound and similar recording media rose from $211 million in 1984 to $421

million in 1988, as exports to all countries rose from $493 million to $1.2 billion. U.S. exports of records, recorded tape, and similar recorded media rose from $472 million in 1984 to $1.0 billion in 1988, as exports to all countries rose from $1.2 billion to $2.8 billion.

Diversion of trade to the U.S. market

If an import-discriminatory levy were passed, some goods from the major Asian suppliers could be diverted, but these would be unlikely to go to the U.S. market, because these suppliers already hold more than 75 percent of the U.S. market.

U.S. investment

A directive concerning the issues raised in the paper would encourage U.S. investment, particularly in those country markets where pirates have held a major share, because the copyrightholder would be able to enforce and pursue rights with effect. Uniform or harmonized copyright protection in the EC would allow U.S. rights holders to enforce their rights, presumably with good effect against pirates. U.S. firms could be expected to make greater efforts to protect their rights and benefit from reduced administrative costs in establishing and pursuing those rights.

U.S. Industry Response

The United States is a primary source of the various recorded video and audio entertainment sold in the EC today; however, as indicated previously, much of these sales are pirated. The U.S. industries could be expected to vigorously pursue pirates under harmonized or uniform copyright protection, while expanding sales and investment to replace the pirated products.

Views of Interested Parties

The NAM Report states generally that broadening copyright protection in the EC would complement similar steps in the United States that have been supported by industry.

The USCIB Statement indicates that it supports full copyright protection for data bases, as opposed to a sui generis form of protection. It also gave general support for the EC approach on piracy, but looked for more emphasis on enforcement and the question of piracy in the merchandising of copyrighted characters and works. As to audiovisual home copying, it advocated, with some dissension, that technical measures be pursued to limit unauthorized duplication of copyrighted works on home audiovisual equipment, especially with respect to DAT machines. The USCIB took no position on the issues of distribution rights, exhaustion, and rental rights.

Both the NAM Report and the USCIB Statement refer to the proposed directive on computer programs and the Business Software Association made an extensive submission. This proposed directive is outside the scope of this report, since it was not formally proposed until after December 31, 1988.

Patents

Background

Most of the member states of the EC have well-developed patent laws. Outside the 1992 program, the EC is in the process of ratifying the proposed Community Patent Convention. Some member states are members of the European Patent Convention, which provides for the grant of a bundle of national patents on the basis of a single application filed with the European Patent Office.

A major issue facing many countries is the patent protection to be accorded biotechnological inventions. The member states of the EC are no exception. Some have attempted to resolved this, but in various ways. As part of the 1992 program, an effort is being made to partially harmonize national patent laws with respect to biotechnological inventions.

Anticipated Changes

Proposed directive 88/496 would achieve at least partial harmonization of the patent laws of the member states with respect to biotechnological inventions.

The proposed directive provides that the subject matter of an invention shall not be considered unpatentable simply because it is composed of living matter. Micro-organisms and microbiological processes would be patentable, as well as plant and animal material that is not in the genetically fixed and stable form of a variety. Plant genus or species protection by patent would not preclude other legal protection, i.e., plant-variety protection. Some human intervention would be required, but the fact that the subject matter of the invention occurs naturally would not necessarily preclude patentability.

The proposed directive also sets out standards for the scope of protection, provides for a dependency license for plant varieties, sets rules for deposits, and provides for reversal of the burden of proof for process patents.

Possible Effects

U.S. exports to the EC

The proposed directive will probably liberalize trade by creating opportunities for U.S. producers of biotechnological products to enter the EC market. The directive would provide greater patent protection to inventors and marketers of biotechnological products than currently exists. Biotechnology is a rapidly growing industry whose products (including micro- and microbiological organisms) are not adequately protected under

traditional patent law. Greater patent protection would not only stimulate research and development in this industry by both EC- and non-EC-based firms, it also would reduce the marketing risks associated with introducing biotechnological products into a new market.

The U.S. industries most likely to benefit from this directive are agriculture (including food products) and chemicals, because these are the areas where biotechnological research is most active. For example, U.S. firms and Government agencies (such as the Office of Agricultural Biotechnology of the Department of Agriculture) annually invest millions of dollars in the development of biodegradable plastics (made by adding substances like cornstarch to sheet plastic), which benefits the waste-removal and food processing/packaging industries; the latter in turn operate in all EC food markets, both by direct export and local production/marketing. Developments in genetics increase crop yields and improve livestock efficiency, thus increasing U.S. competitiveness in world markets for grains, vegetables, meats, and other commodities. In many of these areas, U.S. firms are also leading EC manufacturers, and as such they stand to gain from more secure patent protection when they transfer U.S.-developed technology to their EC operations. The chemicals industry, including firms such as Hoffman-LaRoche, Upjohn, and duPont, which operate in both the United States and the EC, invest millions annually in the development of proteins, environmentally safe pesticides and herbicides, vaccines, and other microbiological products. These products also will be more easily marketed in the EC if patent protection is increased.

In fiscal 1987, U.S. federal funding of biotechnological research and development totaled $2.7 billion. Data on private funding are not available but are believed to be of a similarly high magnitude. The quantitative effects on U.S. exports attributable to such research and development cannot be determined with any acceptable degree of accuracy.

Diversion of trade to the U.S. market

Japan is the only significant non-EC competitor with the United States in biotechnology. Japan is a major inventor and producer of biotechnological products. According to the U.S. House Subcommittee on Agricultural Research, Committee on Agriculture, Japan has "a strategic plan to achieve superiority in biotechnology . . . by the mid-1990's." However, Japan would probably benefit to an extent similar to the United States if this directive is approved. Therefore, with no probable adverse effect on its trade with or investment in the EC, Japan would not need to divert trade or investment to the U.S. market.

U.S. investment

The proposed directive will probably benefit U.S. investment by creating opportunities for scale economies in biotechnology research and development (because it would harmonize the member-state patent laws and regulations). The directive will probably encourage future U.S. investment by creating the aforementioned opportunities for scale economies in biotechnology research and development. If U.S. firms take advantage of any opportunities to increase efficiency, the directive will benefit U.S. businesses currently conducting biotechnological research and development. By harmonizing member-state patent laws, the directive allows firms to more easily expand across member-state borders without the constraint of different sets of regulations.

U.S. Industry Response

U.S. industries are likely to expand their investment in EC biotechnology, both to take advantage of efficiency opportunities and to meet the improved competition from EC firms that is likely to result from the directive.

Views of Interested Parties

No formal submissions were received.

Possible Effects

Generally, any improvement or standardization in intellectual property protection will benefit U.S. commercial interests in the EC. It will also benefit U.S. investment and operating conditions in the EC.

PART III

IMPLICATIONS FOR THE GATT AND OTHER INTERNATIONAL COMMITMENTS

CHAPTER 13
RECIPROCITY

CONTENTS

Chapter 13

Reciprocity[1]

Introduction

During 1988, the Commission of the European Communities (the EC Commission) introduced the notion of reciprocity into the EC 1992 program by incorporating "reciprocity clauses" into several proposed directives.[2] The U.S. Government and U.S. business sources opposed these provisions because they feel that such provisions could lead to discrimination against U.S. firms, particularly in the fields of banking, financial services, and insurance. Also, the European Community has suggested that it will take reciprocity into consideration as it implements other measures to liberalize trade with respect to third countries in sectors not subject to the General Agreement on Tariffs and Trade (GATT). However, the U.S. Government believes that reciprocity is inconsistent with the principles of national treatment and nondiscrimination upon which international commercial relations is based; thus, it is the U.S. view that reciprocity could impede the progress of liberalization in ongoing and future multilateral trade negotiations.

This chapter will provide a framework for understanding the controversy over reciprocity and market access in the context of U.S.-EC relations. The analysis will begin with a discussion of the central concepts of reciprocity, national treatment, and right of establishment. Summaries of reciprocity provisions in EC directives[3] and an EC Commission statement on reciprocity will follow. The chapter then presents the views of U.S. Government officials and officials of EC member states and the EC Commission. Finally, a sectoral analysis addresses the possible effects of reciprocity on U.S. business.[4] The discussion can neither offer a definitive explanation of how the EC intends to use reciprocity as a tool in the formation of the single market nor predict exactly how the United States will be affected by such a policy; the former is the subject of continuing intra-EC and transatlantic debate, and the latter is necessarily dependent on the outcome of that dialogue.

Background

In 1988, three proposed directives designed to implement White Paper proposals to establish a single internal market by 1992 indicated that access of third-country firms to EC banking, financial services, and life insurance markets would be contingent upon European Community firms' receiving "reciprocal treatment" from the non-EC firms' home countries. Language in a fourth directive provides for liberalization of capital flows on a reciprocal basis. Another directive allows an exchange of information regarding credit exposures. Finally, the EC Commission has said that it will seek reciprocity as a condition in the opening up of public sector procurement.

Reciprocal treatment could be interpreted to mean anything from an identical regulatory and operating framework to nondiscrimination. Initially, however, the EC Commission did not explain how reciprocity would be defined or implemented. The lack of such an explanation led to concerns on the part of U.S. Government and industry officials that a policy of reciprocity would allow the EC to discriminate against U.S. firms. For example, if the European Community required market opportunities abroad that were identical to those in the single EC market as a condition for establishment of third-country firms, U.S. banks could be denied entry on the basis of U.S. legislation that separates commercial and investment banking and prohibits interstate banking. The insurance industry is likewise subject to state-specific regulation and does not operate in a unified national market.

Although the EC has assured that reciprocity will not be applied retroactively, U.S. firms already established in the European Community are concerned that their rights may not be recognized in the final approved reciprocity provisions. Further, a "reciprocity test" is seen by many, both within and outside the European Community, as a barrier to liberalization of trade in services and the free flow of capital as well as inconsistent with provisions of the Treaty of Rome and existing international commitments.[5] Specifically, the U.S. Government interprets the international standard of national treatment in commercial relations—including investment and banking services—to be unconditional.

[1] The amended proposed art. 7 of the Second Banking Directive replaced the term "reciprocal treatment" with "effective market access." However, this article is still referred to, even by EC officials, as a reciprocity clause and will be so described in this chapter.

[2] The term "directive" as used in this chapter refers to directives, recommendations, communications, and proposals thereof.

[3] All the directives with reciprocity clauses are discussed in full in other chapters of this report, as specified. The reciprocity provisions of the Second Banking Directive have undergone several revisions; this chapter discusses the original proposal published in March 1988, the amended proposal published in May 1989, and a third version agreed to in principle in June 1989.

[4] The reaction of U.S. Government and industry officials to the June 1989 revised reciprocity clause was unavailable and is not presented in this report.

[5] This chapter makes numerous references to the GATT, the Organization for Economic Cooperation and Development, and bilateral treaties. For a more complete discussion of these organizations and agreements and their relationship to the 1992 program, see chs. 14 through 16 of this report.

The amended proposed reciprocity provisions of the Second Banking Directive somewhat diminished these concerns, although the amended language does not satisfy all critics of reciprocity. The June 1989 revision of this article incorporates a "grandfather" clause and further specifies implementation procedures. However, these changes and clarifications apply only to the banking provisions.

The Concepts

Much of the controversy over EC reciprocity provisions is due to the fact that the central concepts of reciprocity, national treatment, and right of establishment lack concrete definitions and may be interpreted differently in different contexts. Further understanding of these terms may be obtained by considering precedents and interpretations that exist in international agreements and by comparing these precedents and interpretations to use of the same terminology in the EC directives.

Reciprocity

EC directives and press releases do not explain how the European Community defines or interprets reciprocity. *Webster's Ninth New Collegiate Dictionary* defines reciprocity as "a recognition by one of two countries or institutions of the validity of licenses or privileges granted by the other." As this definition indicates, reciprocity is a highly subjective concept and is thus open to a wide range of interpretations and applications.

Reciprocity is an old and familiar term in international commercial relations. The United States' oldest trade agreement, the Convention to Regulate Commerce, of July 3, 1815, with the United Kingdom, establishes "a reciprocal liberty of Commerce" between the countries.

The GATT

The GATT is based on a principle of overall reciprocity—trade liberalization is achieved by the granting of concessions by all member nations in such a way that the balance of benefits to each is mutually advantageous. Indeed, the GATT allows for retaliation by a member state for the impairment of trade opportunities in one market to take the form of withdrawal of trade opportunities for the offending party in a completely different market. In the directives, EC reciprocity provisions are not presented in terms of an overall, nonsectoral balance of benefits. However, in an October 19th statement on reciprocity, the EC Commission stated that third countries may benefit from the single market "to the extent that a mutual balance of advantages in the spirit of GATT can be secured."

Bilateral agreements

Broad bilateral trade agreements may likewise incorporate a concept of overall benefits to the parties; such bilateral reciprocity is sometimes measured in terms of market access. However, because the most important issues of trade between a small number of countries are more readily identifiable, general concessions may in fact be targeted at certain sectors. In the area of government procurement, COM(88) 376 calls for reciprocity in the form of "equilibrium" in commercial relations and "equal access to similar markets." This document merely sets the stage for the preparation of European Community government procurement legislation; however, sector-specific directives contain no clearer reciprocity provision. The accompanying explanatory memorandums note only that the EC is negotiating a mutual opening up of procurement with the European Free Trade Association.

Sectoral reciprocity

Other multilateral and bilateral trade agreements are clearly sector specific, with the granting of concessions and enjoyment of benefits strictly limited in scope. Sectoral reciprocity is theoretically less trade liberalizing than overall reciprocity because it allows nations to shelter selected products and services. However, for a nation that is obliged to protect some sector for reasons of economic stability, political sensitivity, or national security, sectoral reciprocity may be a more acceptable way to lower trade barriers.

Although the October 19th statement suggests a concept of overall reciprocity, other factors indicate the application of sectoral reciprocity. First of all, for the EC, economic stability will be a concern since liberalization is being broadened in the financial sector. Also, moving towards EC-wide government procurement policies will be politically sensitive. Most specifically, the 1992 directives call for reciprocity in the cited sector and activity, e.g., establishment of subsidiaries.

There are any number of variations of sectoral reciprocity in practice. At the most restrictive end of the spectrum is mirror-image reciprocity, which calls for the near-identical treatment by trading partners of the product or service in question. Clearly, a mirror-image interpretation of reciprocity in the field of services would be highly restrictive. U.S. banking, investment services, insurance, and procurement regulations differ significantly from those in the EC in terms of both form and content, and complete restructuring of the U.S. system would be required to approximate the European Community market. In the October 19th statement, the EC Commission specifically stated that the EC does not intend to apply mirror-image reciprocity. Further, this extreme interpretation of reciprocity is considered improbable because

of the level of financial interdependence and political goodwill between the United States and European Community member states. Nevertheless, the potentially costly and disruptive ramifications of such a policy have caused great concern on the part of U.S. officials and business interests. At the other end of the spectrum of sectoral reciprocity is reciprocal national treatment, which is the policy outlined in the most recent EC Commission statements. Reciprocal national treatment should not be confused with unconditional national treatment. These policies are discussed further below.

Sectoral reciprocity may also serve as a tool of international trade liberalization, encouraging the opening up of foreign markets with the promise of reciprocated market access. This use is cited by European officials as the major objective of the EC in its reciprocity provisions. International trade liberalization is, likewise, the stated purpose of sections of the U.S. 1988 Trade Act that the European Community has characterized as reciprocity provisions.[6]

National Treatment

A country practices a policy of national treatment by granting foreign individuals and firms the same rights available to citizens and national firms. Similarly, nondiscrimination requires that third-country suppliers not be disadvantaged compared with domestic suppliers. These principles are the keystone of international trade liberalization, as formalized in article III of the GATT and the codes and instruments of the Organization for Economic Cooperation and Development (OECD). The United States and EC member states are party to both these agreements. Friendship, commerce, and navigation (FCN) treaties between the United States and most EC member states also espouse these guidelines. Moreover, article 58 of the Treaty of Rome grants national treatment to foreign-owned firms established in the European Community.

The OECD

In the field of financial services in particular, the 1976 OECD Declaration on National Treatment established the policy as the standard of behavior of signatory states towards foreign investors. In 1984, the Code on the Liberalization of Capital Movements was broadened to acknowledge the right of establishment of foreign investors. Exceptions to national treatment are allowed, but countries are required to report all such derogations. Within the OECD, national treatment is unconditional, not reciprocal.

[6] See "EC criticism of the U.S. 1988 Trade Act" below.

Positions of the parties

U.S. Government officials note that EC reciprocity provisions may be used to require that third countries grant national treatment to European Community firms in order to insure that firms from those countries are able to participate fully in the single EC market.[7] Further, the European Community uses the term "genuine national treatment," emphasizing that national treatment must be de facto as well as de jure in application.[8] The United States interprets national treatment, as codified in international agreements, as unconditionally granted and, thus, judges the EC reciprocity clauses to be in conflict with this principle.[9] The European Community asserts that its reciprocity clauses do not and will not breach any agreement to which the European Community is party.[10] Although the United States criticizes the EC reciprocity provisions for not respecting the spirit of GATT, this agreement does not currently apply to banking, securities, and insurance, although negotiations are under way to expand the scope of liberalization in trade in services. Also, the OECD National Treatment Declaration is nonbinding, exceptions are possible from requirements of the codes, and financial services are often excluded from FCN treaties.

The terms of the amended proposed reciprocity language still allow the EC Commission to limit or suspend requests for new authorizations and acquisitions of firms from a third country; however, any limitation or suspension would be conditional upon the country's denial of national treatment to EC firms. Also, European Community action is discretionary and, according to EC Commission Vice President Sir Leon Brittan, will only be undertaken when there is "national discrimination" against the EC.[11] The EC Commission is required to undertake negotiations with any country so cited. Thus, nothing in the revised reciprocity clause requires the denial of national treatment; rather, it allows the EC Commission to deny national treatment in the establishment of a foreign-owned financial institution if the European Community is denied national treatment in the financial markets of the firm's home country. Also, the June 1989 revision limits the competence of the EC Commission in this area by giving the Council

[7] USITC staff meetings with officials at the U.S. Treasury and the U.S. Department of State.
[8] "Commission clarifies reciprocity provisions in proposed Second Banking Directive," EC Commission press release, Apr. 13, 1989, p. 2.
[9] *An Initial Assessment of Certain Economic Policy Issues Raised by Aspects of the EC's Program: A Public Discussion Document*, Internal Market Public Document 1288, December 1988, p. 3.
[10] The amended proposed art. 7 of the Second Banking Directive, par. 6.
[11] "Commission clarifies reciprocity provisions in proposed Second Banking Directive," EC Commission press release, Apr. 13, 1989, p. 2.

additional control over the implementation of reciprocity.

Whatever its terms, the United States opposes the principle of reciprocity in international commercial relations to the extent that such a policy may deny the international standard of national treatment.[12] However, it is unclear whether using the reciprocity clauses would be in conflict with the EC's international commitments.

Right of Establishment

Reciprocity clauses in banking, investment services, and insurance directives provide that authorizations to establish may be suspended. As noted above, the OECD Capital Movements Code acknowledges the right of establishment of foreign investors—a right that is not conditional upon reciprocal treatment. Reciprocity, as envisioned in both the amended proposal and the June 1989 revision, could restrict this right. The prima facie concern is the denial of national treatment in the right of establishment.[13] Also, however, any qualification of this right is of special concern to foreign-owned firms already established in the EC by the date of implementation of directives containing reciprocity provisions.

Retroactive reciprocity

The threat that firms already established in the EC could be subject to the EC reciprocity provisions caused an outcry from such firms, which feared that their operations and their investment could be jeopardized.[14] The financial sector can be affected by intangible external influences; thus, some degree of stability and predictability in the marketplace is often seen as important for corporate planning and long-term investment. Although U.S. firms in Europe remain optimistic, they are concerned that their future status and freedom of operations may depend on external and economic developments that they can neither foresee nor directly affect.[15]

Many U.S. subsidiaries have been in the European Community for decades and consider themselves to be European firms. They and other critics characterize the use of reciprocity as a criterion in providing access to the EC as a violation of article 58 of the Treaty of Rome, which grants foreign-owned firms authorized in member states the same rights as firms of that member state, regardless of the nationality of the parent company. Reports that the EC Commission Legal Service reviewed article 58 as it applied to foreign investment exacerbated these concerns. If an established subsidiary of a non-EC-owned firm applied for authorization for a new or restructured operation, and that authorization were suspended, the subsidiary's right of establishment would be compromised. In the October 19th statement, the EC Commission assured that reciprocity would not be applied retroactively. Industry sources note, however, that, in the amended proposal, foreign firms are only "grandfathered" as long as they choose not to alter their corporate structure. The October statement did not assure that established foreign-owned firms would be free to expand services or otherwise restructure their operations without being subject to the same reciprocity constraints as new entrants. However, a provision in the June 1989 revision may satisfy industry concerns by excluding existing foreign-owned subsidiaries from any limitation or suspension of authorization.

Grandfathering

Some foreign financial institutions and other commentators called upon the EC Commission to recognize the rights of established foreign-owned firms in the post-1992 EC.[16] However, the amended proposed reciprocity language offers no such grandfathering provision. Rather, the amended proposal requires newly authorized firms to report their ultimate parent. This requirement suggests that the European Community may at some point wish to identify the firm as foreign owned. Whereas the amended proposal is seen by many as a significant improvement over the original, the issue of right of establishment is, if anything, even more disconcerting.[17] The June 1989 revision of article 7 provides that limitations or suspensions of authorizations will not apply to existing EC subsidiaries of foreign-owned firms.

Article 58 of the Treaty of Rome

In part, grandfathering is a "constitutional" issue, in the sense that the EC Commission will want to implement reciprocity in a manner consistent with article 58 of the Treaty of Rome, which guarantees national treatment. In several well-known recent cases, national legislation that impeded the free movement of goods within the European Community was found by the European Court of Justice to be inconsistent with the member state's obligations under the Treaty of Rome.[18] U.S. firms established in the EC could

[12] *An Initial Assessment of Certain Economic Policy Issues Raised by Aspects of the EC's Program: A Public Discussion Document*, Internal Market Public Document 1288, December 1988, p. 3.
[13] National treatment is discussed immediately above.
[14] See, for example, *Reciprocity: A Step in the Wrong Direction*, Bankers' Association for Foreign Trade, (March 1989).
[15] Based on discussions of USITC staff with officials from over 25 U.S. financial institutions.
[16] *Reciprocity: A Step in the Wrong Direction*, Bankers' Association for Foreign Trade, (March 1989), p. 4.
[17] Based on meetings of USITC staff with U.S. Government officials in Brussels.
[18] The most influential of these rulings came in the "Cassis de Dijon" case in 1978.

challenge any European Community measure believed to be in conflict with the treaty.

Subsidiaries vs. branches

Finally, reciprocity provisions apply to the establishment and acquisition of subsidiaries. A larger number of actual offices of foreign-owned financial institutions in the EC are structured as branches. Branches will remain subject to existing host-country and EC regulation. Bank branches will be under the provisions of the First Banking Directive and will not benefit from the single EC banking license provided for in the Second Banking Directive. Although this regime is generally considered satisfactory from the point of view of U.S. financial institutions established in the EC,[19] the benefits available to foreign subsidiaries will cause parent companies to consider the advisability of restructuring. It remains to be seen whether the administrative and legal framework of foreign-owned firms in Europe will be significantly affected by these provisions.

EC Source Documents

The Original Proposed Second Banking Directive[20]

Article 7 of the original proposed Second Banking Directive, published in March 1988, provides that, "requests for authorization of a subsidiary whose parent undertaking is governed by the laws of a third country" should be reported to the EC Commission by the potential host member state. The EC Commission would likewise be informed when "an undertaking governed by the laws of a third country is considering the acquisition of a participation in a credit institution such that the latter would become its subsidiary." Authorization of either activity would be suspended for a 3-month period while the EC Commission examined "whether all credit institutions of the Community enjoy reciprocal treatment, in particular regarding the establishment of subsidiaries or the acquisition of participations in credit institutions in the third country in question. If the [EC] Commission found that reciprocity was not ensured, it could extend suspension of [authorization]," in which case it would be required to propose to the Council how the European Community might obtain such reciprocal treatment.

[19] *Reciprocity: A Step in the Wrong Direction*, Bankers' Association for Foreign Trade, (March 1989), pp. 5 to 6.

[20] See ch. 5, on financial services, for further discussion of this directive.

Article 7 of the Amended Proposed Second Banking Directive

In the amended proposed article 7, published in May 1989, the EC Commission is tasked with undertaking a study of "the treatment of Community credit institutions . . . regarding the establishment and carrying out of banking activities, and the acquisition of participations in credit institutions of third countries." This study would be completed 6 months prior to the entry into effect of the Second Banking Directive. Also, member states would inform the EC Commission of "general difficulties encountered by their credit institutions in establishing or carrying out banking activities" in third countries. If the EC Commission determines that EC credit institutions are not afforded "effective market access" and competitive opportunities in a third country comparable to those granted by the European Community to credit institutions of that country, the EC Commission may propose to the Council how such access and opportunities may be negotiated. The EC Commission would continue to be informed by member states of requests for authorization of a foreign-owned subsidiary or of the acquisition by a foreign firm of a controlling participation in an EC firm, but such authorization would not be automatically suspended as previously proposed. A provision absent from the original article 7 calls upon newly authorized subsidiaries to identify their "ultimate parent." Finally, if the EC Commission determines that European Community credit institutions do not enjoy national treatment and effective market access in a third country, the EC Commission may suspend authorization by member states of new credit institutions owned by that third country. The European Community has not formally provided specific terms that it would accept as "effective market access" although this issue has been discussed with U.S. officials, as specified below.

The June 1989 Revision of Article 7

On June 19, 1989, the finance ministers of the member states reportedly agreed, in principle, to a revision of the Second Bank Directive.[21] If the revision is finalized, the EC Commission will have less control over the interpretation and implementation of reciprocity sanctions. Such control would then shift towards the Council of Ministers. Also, the rights of established subsidiaries of third-country parent firms would be more clearly recognized. The Council reached consensus approval of these and other changes.

[21] *European Report* (June 24, 1989). The official text of the common position had not been released to the public at press time for this report.

Final approval may depend on the positions of member states in other areas of the 1992 program. European officials and observers note that sensitive issues of social policy and taxation remain unresolved, and they agree that individual member states will have to make concessions in one area or another. It is beyond the scope of this chapter to predict where such concessions will occur; however, the following discussion is based on the language of the amended proposed article 7 of the Second Banking Directive as adopted in the directives on banking, securities investment, and life insurance.[22]

Securities and Insurance Directives

Reciprocity clauses similar to article 7 of the Second Banking Directive subsequently were introduced into two other directives. A proposed directive on investment services in the securities field, COM(88) 778, in article 6, outlines the exact same procedures as those in the Second Banking Directive's original article 7 for a foreign-based firm that wants to establish or acquire a securities investment subsidiary in the European Community.[23] Substantially identical language is incorporated into article 9 of the Second Life Insurance Directive.[24] Although there is no formal linkage, EC officials and industry sources indicated, in April 1989, that these provisions were expected to be replaced by language similar to the amended article 7 of the Second Banking Directive. Also, reciprocity provisions may be incorporated into additional directives in fields not subject to GATT agreements.

Other References to Reciprocity in Financial Services

The above reciprocity provisions have been a source of concern for U.S. officials and financial services providers; however, references to reciprocity in other directives have been characterized by U.S. industry sources as "good reciprocity" in the sense that they pose no constraints on the United States and encourage further liberalization between the European Community and U.S. financial markets. For example, article 7 of Council directive 88/361[25] states that, "[i]n their treatment of transfers in respect of movements of capital to or from third countries, the Member States shall endeavour to attain the same degree of liberalization as that which applies to operations with residents of other Member States. . . ." However, these provisions "shall not prejudice the application to third countries of domestic rules or European Community law, particularly any reciprocal conditions, concerning operations involving establishment, the provisions of financial services and the admission of securities to capital markets."

EC Commission recommendation 87/62 sets guidelines for monitoring credit exposures.[26] Article 5 states that application of the recommendation to third countries "may be the subject of bilateral agreements, on the basis of reciprocity, . . . to ensure that Member States' competent authorities are able to obtain the necessary information to enable the large exposures of a credit institution within the Community . . . to be monitored and controlled . . . ."

The October 19th Statement

U.S. Government officials and business spokespersons reacted with consternation to the publication of the Second Banking Directive proposal.[27] Specifically, it was suggested that the EC could require "mirror image" reciprocity, i.e., an identical regulatory and operating framework, as a condition of free access to the European Community market. Also, the automatic suspension of authorization applicable to foreign-owned firms was seen as a barrier to entry. Both these provisions were felt to be inconsistent with existing international commitments. Concern was further heightened during the summer by statements from EC Commissioner Willy De Clercq suggesting that the European Community could apply reciprocity retroactively, possibly denying established U.S. and other foreign-owned firms the status and, perhaps, the rights of EC-owned firms after 1992.

The European Community attempted to clarify its position on reciprocity with the press release of October 19, 1988, "1992: Europe—World Partner." The statement is a rare example of the European Community publicizing the outcome of an internal policy

[22] Insufficient time was available to solicit comments from industry officials on the revised reciprocity clause of June 1989, especially considering that that revision is not publicly available.
[23] See ch. 5, on financial services, for further discussion of this directive.
[24] Ibid.
[25] Ibid.
[26] Ibid.
[27] See, for example, Deputy Secretary of the Treasury M. Peter McPherson's remarks to the Institute for International Economics, Aug. 4, 1988; Secretary of Commerce William Verity's remarks before the U.S. Business Roundtable and the U.S. Council for International Business, Oct. 18, 1988; American Express Senior Vice President Joan E. Spero's presentation at the International Business Council, Sept. 29, 1988; and Salomon Brothers Business Analysis Department Vice President Graham Bishop's speech before senior industrialists in Japan and Hong Kong, week of Oct. 17 to 21, 1988.

debate. The release stated that, "the Community has a fundamental stake in the existence of free and open international trade;" however, "[t]he [EC] Commission reserves the right to make access to the benefits of 1992 for non-E.C. firms conditional upon a guarantee of similar opportunities—or at least nondiscriminatory opportunities—in those firms' home countries." Referring specifically to the Second Banking Directive, the EC Commission assured that reciprocity would not be applied retroactively. Further, the statement clarified that the EC did not intend to require reciprocity in the form of either similar legislation or "comparative trade levels." However, no such assurances were made regarding the freedom of non-EC firms to establish or acquire subsidiaries or of established foreign-owned firms to expand services, after 1992. The October statement further emphasized that the 1992 goals would not conflict with the European Community's existing international obligations, and, in sectors where such international rules do not apply, the EC would seek greater liberalization through multilateral and bilateral negotiations. Perhaps of greatest concern to U.S. interests, the EC Commission did not specify conditions that it would recognize as reciprocal treatment, but, rather, suggested that decisions would be made on a case-by-case basis by the European Community. Case-specific decisions could be lengthy and subject to political pressure, and companies applying would have relatively less certainty about the outcome and would perhaps be less apt to pursue an establishment that would otherwise be advantageous.

Although the October 19th statement provided insight into the EC's intentions regarding the use of reciprocity and also offered some assurances to established foreign-owned firms in the European Community, it did not otherwise satisfy critics of the policy. External and internal debate continued, and the EC Commission was asked by the finance ministers of the member states to redraft the reciprocity provisions of the Second Banking Directive. The amended proposal, published in May 1989, significantly altered the provisions of the original article.

Government Procurement

The text of a proposed communication on an EC regime for government procurement in the areas of water, energy, transport, and telecommunications notes that legislation for opening up these sectors should "include provisions which will ensure that the equilibrium of the European Community's commercial relations with third countries is maintained. Access to relevant European Community markets should not be conceded until equal access to similar markets in third countries is guaranteed." Similar clauses are incorporated into sector-specific proposed directives.[28]

Positions of the Parties

The EC[29]

European Community and member-state officials note that, with the introduction of a single banking license, free movement of capital, and harmonization/recognition of insurance standards, the EC will become the largest market for financial services in the world, as well as one of the most liberal. EC and French officials interviewed by USITC staff explained that a reciprocity clause was incorporated into the Second Banking Directive not as a barrier of entry but rather to enable the European Community to obtain a fair deal from its trading partners in return for allowing free access to the opportunities of this market. These officials regarded the U.S. reaction to the original article 7 of the Second Banking Directive as unwarranted and uninformed. The more critical European officials and observers characterized the U.S. position as defensive posturing.[30]

EC criticism of the U.S. 1988 Trade Act

A representative of an EC services trade organization suggested that De Clercq's statements were the EC's posturing in relation to the United States, where approval of the 1988 Trade Act was pending. Although it is outside the scope of this discussion to comment on aspects of U.S. trade law, an understanding of EC criticism of the U.S. 1988 Trade Act will assist the reader in understanding the European Community's reaction to the U.S. criticism of EC

[28] See ch. 4, on government procurement, for further discussion of the directives.

[29] Based on meetings of USITC staff with officials from the French Treasury and stock exchange; a French services-trade expert; Belgian officials from the Ministries of Finance and Foreign Affairs; a Belgian insurance specialist; an official at an international business organization; the head of an EC service industries trade organization; EC officials in the Finance Directorate's Divisions of Insurance, Financial Conglomerates, Capital Movements, Banking, and Securities and from the Directorate for External Relations; and British officials from the Treasury, the Department of Trade and Industry, the Securities and Investment Board, the Bank of England, and the stock exchange. British views differed from the others as specified below. These meetings were held in April 1989 and did not address the June 1989 revised reciprocity clause. Further information was obtained from submissions by interested parties.

[30] Several European officials stated that De Clercq's statements last summer were unfortunate in that they gave the United States and others the incorrect impression of an intended "Fortress Europe." One EC Commission spokesman explained that, in reference to retroactive reciprocity, De Clercq was giving an ad hoc answer to a question from a member of the European Parliament and that this never was the official position of the EC Commission.

reciprocity provisions. In defending EC reciprocity provisions, Europeans point to the U.S. Trade Act as easily more objectionable. European officials have criticized several provisions of the Trade Act as protectionist, including several that they characterize as reciprocity clauses.[31] Parallels may be drawn between U.S. and EC legislation that is cited as "protectionist," yet the manner of implementation/enforcement is quite different, and, in that respect, the consequences may be dissimilar.

Barriers to the U.S. market

In defending their position, EC officials state that reciprocity is envisioned as a tool to liberalize foreign markets rather than to "protect" the European Community. No European official interviewed during investigative fieldwork suggested that U.S. financial institutions would encounter any difficulties in establishing subsidiaries after 1992.[32] Despite different U.S. and EC administrative and legal frameworks, all European officials and observers agreed that the U.S. grants de facto national treatment in financial services.[33]

[31] On several occasions during investigative fieldwork, it was stated that the amended proposed reciprocity language proposes a legal and institutional framework similar to certain U.S. provisions. For example, the 1988 Trade Act requires the President to enter into negotiations with "priority countries" to obtain "mutually advantageous market opportunities. . ." in telecommunications. An EC analysis and commentary on this provision objects to the concepts of "*sectoral reciprocity* and *mandatory action*" upon which the legislation is "based." (*Omnibus Trade and Competitiveness Act of 1988—Analysis*, Commission of the European Communities [Sept. 8, 1988], p. 9. Emphasis appears in the original.) Further, the analysis criticizes the United States for undertaking to identify, unilaterally, barriers and "mutually advantageous . . . opportunities." Secs. 1105 (negotiating authority) and 3603 (trade in financial services) and the Primary Dealers Act likewise contain provisions that may be seen as similar to those to which the United States has objected in EC reciprocity clauses. The EC has objected most strongly to sec. 301 provisions: "[u]nilateral determination by the US of what constitutes major barriers and trade distorting practices," in conjunction with "other unilateral judgments, e.g. on trade agreement violations or what is justifiable, as well as with US imposed time limits for negotiation and retaliatory action if no acceptable solution is found is certainly contrary to GATT rules...." (Ibid., p. 5). See also the *European Community Report on US Trade Barriers*, Commission of the European Communities, 1989, released May 3, 1989.

[32] On May 3, 1989, the EC released its annual report on U.S. trade barriers. This report discusses barriers in financial services; however, the emphasis in the introduction and summary press release is on provisions of the 1988 Trade Act, "Buy America" restrictions, the Superfund oil import levy, and customs user fees.

[33] One person noted that certain U.S. States have provisions limiting the activities of foreign banks.

Barriers to the Japanese market

On the other hand, frequent references were made to the difficulties experienced by EC financial institutions in establishing a presence in Japan. Indeed, most sources suggested that Japan is the target of EC reciprocity provisions. Officials acknowledged that the policy will be helpful in negotiating better access to Japanese capital markets. However, several persons noted that Japan, since the publication of the original reciprocity article, has strengthened its contacts with the EC and is actively pursuing negotiations with the EC Commission on mutually acceptable terms in the area of bilateral trade in financial services. One EC Commission official predicted that by the time any directives with reciprocity clauses come into effect, the European Community will have satisfactorily concluded discussions with Japan and no suspensions of authorization of its firms will be considered. This is not to say that the European Community may not wish to negotiate certain aspects of bilateral trade in financial services—the EC may pursue discussions with the United States as well. For example, European Community officials generally acknowledged that they would like to see both the United States and Japan move towards a more universal and less regulated banking system. These officials noted that internal pressures in both nations are leading this way.

British views

Finally, it must be noted that the Europeans are far from a consensus on reciprocity. The United Kingdom, in particular, remains opposed to the principle of reciprocity, and the West Germans concur in certain respects. Observers noted, however, that the British risk being seen as the Americans' "trojan horse" if they align themselves too closely with the U.S. position. Such a perception would undermine British leverage in other areas of European Community policy. Another problem the United Kingdom has in opposing European Community reciprocity language is the existence of its own reciprocity provisions in the Financial Services Act. Although spokespersons pointed out that these provisions are reserve powers that have never been invoked, nor are they likely to be under the current Government, British law does provide for action against a nation on the basis of its treatment of British companies. In conclusion, business sources suggested, and certain British officials agreed, that the United Kingdom might be willing to accept the current version of reciprocity in return for concessions by other member states on issues such as worker-participation legislation and tax harmonization.

The United States[34]

The U.S. Government is opposed to the policy of reciprocity as presented in the Second Banking Directive, the Investment Services Directive, and the Second Life Insurance Directive because it could result in discrimination in these sectors. The United States and EC member countries belong to the OECD, which calls for national treatment in financial services and recognizes the right of establishment of foreign investors, regardless of national origin or home-country policies and practices.

Reaction to the original article 7

Prior to the May 1989 change in the reciprocity language, U.S. criticism had concentrated on the fact that the provisions required the denial of national treatment when a country was judged not to provide reciprocal treatment. Although many officials and observers held that the EC would not consider the U.S. financial regulatory system discriminatory in the sense that mandated retaliatory action under the reciprocity provisions, the lack of clarity in the provisions could have required such discrimination if mirror-image reciprocity were demanded. In taking a relatively pessimistic view of future U.S. access to European markets, observers were acknowledging a common-sense reality—the opening up of EC banking and other services markets will inevitably cause some degree of dislocation. Some of the smaller national banks and insurance companies are ill-equipped to compete with large multinational firms in an EC-wide market. Certain voices in Europe will seek to protect national interests.

These initial U.S. concerns were addressed in part by the EC Commission in several forums: public statements, private discussions, and in the amended proposed language. The term "reciprocal treatment" was replaced by "equivalent market access and competitive opportunities comparable to those accorded by the European Community to credit institutions of that third country" in the amended proposal, and the EC has privately assured that U.S. banking regulations will be considered to grant such access. Further, the automatic suspension mechanism has been replaced by discretionary action. The EC Commission study will identify countries seen to impose barriers to establishment of financial services and, again, EC Commission sources indicate that the United States will not be on this "priority list." Nevertheless, the United States will want to see the results of the EC Commission's study on foreign treatment of EC institutions, and observe how the clause will be implemented before being entirely reassured on this point.

Continuing concerns

Industry sources and U.S. Government officials note that other concerns have not been satisfied by the EC. For example, the rights of U.S. firms established in the EC are not grandfathered in the amended proposal and U.S. business interests could be seriously harmed if the EC chose to discriminate against U.S.-owned firms. Even assuming that the EC would not take such steps, the threat of retaliatory discrimination could provide the European Community with a negotiating tool harmful to U.S. interests. The U.S. reaction to the revisions of June 1989, which include a grandfathering clause, are not available.

However, the bulk of U.S. criticism is focused on the international ramifications of sectoral reciprocity in trade relations, and these concerns remain paramount. As expressed by the U.S. Government Interagency Task Force on the EC Internal Market, "[reciprocity] is a fundamental departure from the principles of unconditional most favored nation and national treatment, which are embodied in the GATT and the OECD, and have provided the basis for the liberalization of trade and investment in the post-war period."[35] Further, the EC may try to introduce the notion of reciprocity into ongoing GATT negotiations or in the upcoming review of the OECD National Treatment Declaration. In an environment of increasing global competition and the threat of protectionism in the form of regional "trading blocks," reciprocity is a concept that could undermine efforts to liberalize international trade.

As of July 1989, the U.S. Government had yet to make public an official position on either the amended proposed reciprocity provisions or the June 1989 revision. Officials acknowledge that the language of the amended article 7 of the Second Banking Directive is a significant improvement compared with the original version.[36] Also, the EC is quick to point out that similar instruments of trade policy are available to the United States; thus, it could be difficult to continue to pursue a course of confrontation with the European Community on this issue without being forced to defend U.S. trade policy. Further, some observers suggest that, in response

[34] Based on USITC staff meetings with officials from the U.S. Departments of Treasury and State and United States Trade Representative, including staff at the U.S. Embassies in Paris and London and the U.S. Missions to the OECD and to the EC. Most of these meetings were held in April 1989 and did not address the June 1989 revision of the reciprocity clause. Further information was obtained from papers and statements obtained from these sources, the Department of Commerce, and the Congressional Research Service.

[35] *An Initial Assessment of Certain Economic Policy Issues Raised by Aspects of the EC's Program: A Public Discussion Document*, Internal Market Public Document 1288, December 1988, p. 3.

[36] Based on USITC staff meetings with officials at the U.S. Treasury and U.S. Department of State.

to U.S. pressure, the EC toned down reciprocity very significantly in its amended proposal and that further criticism by the United States might be counterproductive to transatlantic relations.

To qualify this discussion of U.S. attitudes towards reciprocity in financial services, it should be noted that an assumption was made that the amended proposed reciprocity language would be adopted. Recent developments suggest that the June 1989 revision of article 7 appears more likely to be approved by the Council. Although U.S. Government and business representatives are unlikely to praise the revised article 7, U.S. opposition to reciprocity could become more insistent if there is any question of the European Community adopting a tougher stance than that currently under consideration.

Possible Effects[37]

In the October 19th statement, the European Community appears to be reserving the right to seek reciprocity in any sector not subject to a GATT discipline. There is the possibility, therefore, that a large number of U.S. industries can be significantly impacted. However, this analysis will address the sectors already targeted by reciprocity provisions—financial services and government procurement.

Financial Services

The reciprocity provisions of the directives regarding capital movements, mutual fund transactions, and credit exposures are not seen by U.S. industry sources as any cause for concern. U.S. regulations generally do not impede capital flows to and from the EC, and the United States grants national treatment (or better[38]) to financial institutions of European Community member states. In fact, U.S. firms see significant potential benefits in the liberalization of European Community capital markets because it will facilitate cross-border transactions within the EC, reduce the cost of doing business, and encourage investment and growth. Also, U.S. regulations already generally meet or exceed the specified minimum guidelines of the credit-monitoring recommendation. Further analysis of reciprocity in this chapter centers on the potential difficulties posed by this policy; thus, the directives oncapital flows, mutual funds, and credit exposures will not be discussed further in this chapter.[39]

U.S. exports to the EC[40]

The effects of reciprocity on U.S. exports to the EC of financial services depend on the outcome of the debate on this issue and the method of implementation. U.S. companies can generally be described as cautiously optimistic that matters will be satisfactorily resolved.

Diversion of trade to the U.S. market

No significant diversion of trade to the United States is expected as a result of reciprocity. Japan appears to be the third country most likely to be affected by EC reciprocity provisions, and Japanese financial-services activities in the EC could be restricted by the implementation of reciprocity. Japanese firms generally have been unrestricted in entering and operating in the United States, and it appears unlikely that they would significantly expand current activities in the United States as a result of restrictions in the EC market. The Japanese have already been expanding aggressively in the U.S. investment market. In insurance, little impact is expected from any trade diversion because of the degree of competition that already exists in the U.S. market and the fact that foreign firms have long played a role in the industry.

Investment and operating conditions in the EC

According to industry sources, the procedures set forth in the original article 7 of the Second Banking Directive to establish or acquire a subsidiary appear to be trade discriminatory. The provision could be interpreted in such a way that all member states would have to determine that they had reciprocal privileges in the home country of the parent firm that was applying to establish a subsidiary. If a financial institution from even 1 of the 12 EC countries could be excluded anywhere in the United States or its jurisdictions from providing any of the services as listed in the annex to the proposal, the application by a U.S.-based financial institution to operate in the EC could be denied.

Regulation in the United States.—In the United States, the Glass-Steagall Act of 1933 segregates commercial banking (accepting deposits and making loans) from investment banking (issuing and dealing in equity, debt, and other financial instruments). Developments are slowly blurring this distinction and granting U.S.

[37] Based on USITC staff discussions and meetings with officials from over 25 U.S. financial institutions, including the EC operations of 5 banks, 1 insurance company, 1 consulting firm, and 1 trade organization. Information was also obtained by attending a panel discussion between officials of U.S. and EC service industries. These discussions and meetings were held prior to June 1989 and did not address the latest revision of the reciprocity clause. Further information was obtained from papers and statements obtained from these sources and in submissions by interested parties.

[38] Certain activities of foreign banks were authorized in U.S. banking legislation, whereas U.S. banks are prohibited from such undertakings.

[39] Possible effects of the 1992 program in banking, investment, securities, and insurance are discussed further in ch. 5.

[40] See ch. 5 for data on U.S. investment and financial assets in the EC.

banks additional investment-banking authority; however, there is continuing controversy in the United States regarding whether this development could imperil the financial system by allowing commercial banks to become more involved in riskier transactions such as underwriting equity and commercial paper and dealing in debt instruments. Also, although regional agreements exist among some States and the trend appears to be toward allowing interstate banking (thus allowing a bank the freedom to open branches in any of the 50 States), at this point interstate banking is prohibited under the McFadden Act. Moreover, banking and insurance are regulated largely on a State-by-State basis.

Universal banking in the EC.—In Europe banking activities are less clearly delineated and the EC appears to be moving towards the universal banking system, which allows banks to offer commercial and investment services as well as insurance. Also, the EC is aiming for a market that is not characterized by competitive distortions caused by different regulatory regimes. If reciprocity were defined as "mirror image" or otherwise narrowly sectoral, it could be noted that the European Community grants U.S. banks greater privileges than the United States permits for EC banks and U.S. commercial banks could thus be precluded from being involved in securities transactions, money-brokering and portfolio management, or from branching across EC member states.[41] Such a development would greatly disadvantage U.S. firms in the European Community market in terms of the services they could provide and the costs they would incur. Therefore, as applicable to U.S. financial institutions, the reciprocity provision in the original article 7 has the potential to be discriminatory.

Industry views.—When interviewed, officials of U.S. banks operating in Europe generally believed that the amended reciprocity provisions of the Second Banking Directive were the best terms that they could expect from the European Community, given the political and economic climate. Further, U.S. firms anticipated that similar provisions would be adopted in the Investment Services and Life Insurance Directives. Although not entirely satisfied with the language, business sources privately generally judged the provisions to be "something they could live with." Generally, U.S. Government and industry officials do not believe that the EC intends to discriminate against U.S. financial services in the foreseeable future; however, these spokespersons emphasized that, at a minimum, the EC Commission should incorporate its stated intentions into the texts of the directives to protect U.S. interests in the future. Ideally, of course, the U.S. officials would prefer striking any and all reciprocity provisions. Organized U.S. business interests in the European Community were undecided on what public position to take on the amended proposed article 7; certainly they welcomed the redraft as an improvement on the original version, but they still objected both in general and on certain specific points.

U.S. banks had called for grandfathering provisions to protect the interests of firms established in Europe prior to the implementation of the Second Banking and Investment Services Directives. However, no such provision was made in the amended proposal, despite the fact that the United States grandfathered in such rights in U.S. banking legislation and in the Canada-United States Free-Trade Agreement. U.S. financial-service providers and their representatives continued to lobby for either a grandfathering clause or equivalent protection of their interests, perhaps in the form of a restatement of their rights as EC firms under article 58 of the Treaty of Rome. These concerns have been addressed in the June 1989 revision. On a related note, U.S. banks questioned what the EC Commission intended with its added requirement of reporting the "ultimate parent" of a newly authorized credit institution in the amended proposal. A precedent exists in the Canada-United States Free-Trade Agreement, but again, existing rights are guaranteed in that pact. This language has also been revised in the June 1989 text.

Most U.S. businesses are still considering how they will be affected by the differing ways in which subsidiary and branch operations will be regulated after 1992. Generally, firms reported that no decision will be made on whether to restructure until the outcome of the reciprocity debate is clearer and until further EC Commission legislation in the financial sector is available. Several companies indicated that their current intent is to maintain the existing structure of their EC operations. An estimated two-thirds of U.S. bank operations in the EC are branches.[42] Restructuring is a costly undertaking and firms are too uncertain about the ultimate design of the EC single financial market to risk a sizable investment at this time. This uncertainty is only partially due to reciprocity issues; of greater concern are other financial-sector issues yet to be resolved by the European Community.

Industry lobbying efforts.—U.S. financial institutions have generally organized their lobbying of the EC through the American Chamber of Commerce in Brussels. The

[41] Under regulation K, the Federal Reserve Board permits U.S. banks to participate in a broader range of activities than that allowed in the United States and provides for the approval and examination of these activities.

[42] USITC staff meeting with an official in the Financial Directorate of the EC Commission.

Bankers' Association for Foreign Trade has also been very active. American Express[43] and Citicorp reportedly have taken the lead in following EC legislation and speaking for the U.S. banking industry, although certain other large U.S. financial institutions reported individual monitoring and lobbying of the EC Commission.[44] It appears that most medium-sized and small banks, including the smaller regional banks established in the EC, are not directly participating in the reciprocity debate. A spokesperson for the U.S. insurance industry likewise sees these efforts as being responsibly spearheaded by other financial institutions.

Government Procurement[45]

Reciprocity in government procurement is completely different than reciprocity in financial services. Rather than barring entry, reciprocity provisions in procurement directives suggest that purchasing by EC member states in water, energy, transport, and telecommunications projects—the four sectors specifically excluded from the GATT procurement Code—could be opened up to third-country suppliers if those countries agreed to consider EC firms in the awarding of their public contracts. Current restrictive practices in the area of government procurement largely limit the involvement of third-country suppliers to the EC market; in fact, only a tiny fraction of public orders goes to firms from other European Community member states. Thus, the United States has little if anything to lose should strict reciprocity provisions be adopted.

At the same time, reciprocity provisions in these directives are not expected to create any immediate new opportunities for companies operating in the United States although U.S. companies operating in the EC will benefit from other aspects of the procurement initiatives. GATT Procurement Code talks are likely to be the forum for negotiating access to EC public sector projects. The EC Commission may seek to use access to excluded sectors as leverage in obtaining concessions from third countries.

In financial services, there have been some clarifications; but in government procurement the issue of reciprocity remains broadly undefined. The positions and concerns of the United States and the European Community have yet to be fully explored. The EC has repeatedly criticized U.S. "Buy America" legislation and is likely to push for a reduction in these "barriers" to foreign products and services.[46] U.S. business is already studying the issue. For example, one spokesperson noted that, in the United States, purchasing by many private utilities is open to all suppliers, whereas this sector is reserved primarily for domestic producers in the EC member states. Accordingly, the United States may find an opportunity here to negotiate improved access to the EC market. On the other hand, another source estimated that, in a recent year, U.S. firms won EC public sector projects worth 10 times the amount won by EC firms outside their home markets.[47] Both the opportunities and disadvantages of the notion of reciprocity in the liberalization of government procurement remain unclear to both business leaders and government officials.

[43] See, for example, testimony by Joan E. Spero before the U.S. House of Representatives Subcommittee on International Economic Policy and Trade, Apr. 5, 1989.
[44] One U.S. official even reported providing technical assistance to the EC Commission in drafting directives.
[45] See ch. 4 for a complete discussion of EC initiatives in the area of government procurement.
[46] For the most recent statements, see the 1989 *Report on US Trade Barriers*, sec. VI, (Commission of the European Communities [May 3, 1989]).
[47] Honeywell Public Affairs Issue Brief on the 1992 Internal Market, (Feb. 3, 1989).

CHAPTER 14
EC INTEGRATION AND THE GATT

CONTENTS

Chapter 14

EC Integration And The GATT

Introduction

The main issues and concerns about European integration that are relevant to the General Agreement on Tariffs and Trade (GATT) and Uruguay Round negotiations are discussed in this section. One of the principal questions that arises as the EC embarks on this major restructuring of its internal market is whether the changes will conform to the EC's international trade obligations and commitments. Many such obligations and commitments are incurred under the General Agreement and other accords that together make up the GATT system. In general, EC trading partners wonder whether the EC will ensure that its transformed customs union meets the spirit and objectives of the GATT, and do so in a manner consistent with article XXIV rules governing customs unions? Trading partners will watching closely to see if new measures or directives are protectionist or inconsistent with GATT rules. Some new practices may require scrutiny, over time, to determine whether they ultimately affect trade with the EC in an adverse or discriminatory fashion.

The United States and other countries share a concern for ensuring that the EC program does not result in increased protectionism or in discrimination against their exports to the EC. If practices that adversely affect U.S. trade interests arise out of the EC integration plan, the GATT and the Uruguay Round can complement bilateral efforts as means to address concerns. For example, under GATT provisions, EC policies that are believed to be inconsistent with the GATT can be challenged and policies that are deleterious, whether or not GATT-inconsistent, may be challenged in the GATT or drawn into Uruguay Round negotiations. Under certain GATT provisions, compensation may be sought for new measures that have adverse effects on U.S. exports.

In guidelines developed on external relations, the EC has said that in creating its internal market it will meet its international obligations and aim to strengthen the multilateral system, but emphasized that it will do so "in accordance with the concept of balance of mutual benefits and reciprocity."[1] In the summit at Hanover in June 1988, the European Council stated, "In conformity with the GATT, the Community should be open to third countries, and must negotiate with those countries where necessary to ensure access to their markets for Community exports. It will seek to preserve the balance of advantages accorded, while respecting the unity and the identity of the internal market of the Community."[2] Such statements are not wholly reassuring because of concerns about the mention of "reciprocity" and the implication that the EC will seek "credit" for liberalization. Further implications of such EC strategies will be reviewed later in this chapter.

Voicing their concerns, U.S. officials such as then-Deputy Treasury Secretary McPherson pointed out that "the temptation on individual issues will be to find a solution that meets the demands of the more protectionist policy interests. This could result in new and greater discrimination in . . . [some areas where] discrimination would violate existing obligations under the OECD, the GATT, and the Tokyo Round codes." McPherson and other U.S. officials have noted with concern a number of issues including right of establishment, mergers and acquisitions, government procurement, subsidies, local-content requirements, and standards and certification, all of which are addressed in this report and some of which will be discussed in this section.[3]

Overview

First, a brief description of GATT and its provisions is presented here to help illustrate how GATT obligations furnish the underpinning of trade relationships between the EC and its trading partners. The aim of the GATT is to encourage liberalized trade among member countries through mutual agreement to limit government intervention that restricts trade. The General Agreement lays out a complex set of rights, obligations, and commitments that members apply among themselves. Essentially, it calls for the reduction and elimination of tariffs and for avoiding the use of other trade measures and commercial regulations that may frustrate trade liberalization. The GATT also periodically sponsors rounds of multilateral trade negotiations (MTNs) to encourage further progress toward trade liberalization.[4]

[1] "External Aspects of the Large European Market: EC Commission Guidelines," *Europe Documents* 1530 (Oct. 25, 1988).

[2] Hanover Declaration of the meeting of the European Council, June 27 and 28, 1988. Support for this position continued to be maintained in the Rhodes Declaration of the meeting of the European Council held Dec. 2 and 3, 1988.

[3] McPherson, Peter M., then-Deputy Secretary of the Treasury, "The European Community's Internal Market Program: An American Perspective," Remarks before the Institute for International Economics, Aug. 4, 1988. See also, U.S. Department of State, *The European Community's Program to Complete a Single Market by 1992*, July 5, 1988, pp. 4 to 5; Verity, C. William, then-Secretary of Commerce, "U.S. Business Should Prepare Now for EC 1992," New York, Oct. 18, 1988; and Lamoriello, Francine, "Completing the Internal Market by 1992: The EC's Legislative Program for Business," *Business America* (Aug. 1, 1988) p. 6.

[4] GATT art. XXVIII bis authorizes rounds of multilateral trade negotiations.

The term GATT, or GATT system, has come to refer to both the General Agreement and a complex structure of affiliated agreements and administrative bodies.[5] It is both a comprehensive set of rules governing many aspects of international trade in goods and a forum for discussions and negotiations on trade-related concerns members may raise. Negotiated in 1947 among 23 countries, the GATT now has 96 member countries, known as contracting parties.[6] The GATT is administered directly by the national delegations of its adherents.[7] The work of the GATT is serviced by a small, nonpolitical Secretariat located in Geneva, Switzerland.

The cornerstones of the GATT are most-favored-nation (MFN) treatment,[8] national treatment,[9] and members' legally binding commitment to preserve the integrity of tariff concessions agreed upon in trade negotiations.[10] Customs and other measures regulating border traffic must meet administrative necessities rather than impede or restrict trade.[11] Article X, in particular, calls for the publication and impartial administration of each member's national regulations governing trade. This provision is known in common parlance as the principle of transparency. The General Agreement calls for the elimination of quantitative restrictions[12] and the elimination of export subsidies.[13] Deviations from the rules are allowed in prescribed situations. One of the most notable is the clause of emergency action, known as safeguards or the escape clause, in which a member is allowed to adopt temporary measures to protect an industry seriously injured by increased imports.[14] Members may also temporarily escape from their obligations when experiencing balance-of-payments difficulties.[15] Other notable exceptions are those for public health and safety[16] and for reasons of national security.[17] As discussed below, GATT provisions on the formation of customs unions and free-trade areas also allow certain deviations from the rules.

Members may handle trade disputes regarding infringements of their rights and obligations by using consultation and dispute-settlement procedures of article XXII and article XXIII, which include the rarely used avenue of GATT-sanctioned retaliation as a last resort. Other mechanisms also aim to preserve the balance of obligations and trade concessions among members. One mechanism is article XXXIII procedures for negotiating concessions upon accession to the GATT. Another is article XXVIII procedures for renegotiating concessions in order to modify tariff schedules. Article XXIV procedures for GATT review and negotiations on customs unions or free-trade areas are also designed to preserve this balance.

Fashioned in the postwar era, when high tariff walls and trade in goods were the predominant concerns of traders, the GATT rules and negotiations dealt most directly with tariffs and applied only to trade in goods. Since that time the scope of the GATT has expanded significantly. In subsequent negotiations, GATT members placed closer scrutiny on the use of nontariff barriers. In

[5] In this chapter, the acronym GATT, as commonly used, refers not only to the agreement but also to the Secretariat and bodies administering it and to the whole of trade-related activities carried out under its auspices. The use of the term General Agreement refers solely to the actual legal document.

[6] In this report, the conventional practice is followed of using the term "Contracting Parties" (capitalized) to refer to the parties to the General Agreement taking formal action as a body. References to individual contracting parties, or to several contracting parties, are lowercase.

[7] The Contracting Parties hold a formal session once a year attended by high level delegates. On a monthly basis, the Council of Representatives, acting of behalf of the Contracting Parties, holds working level sessions. In this manner, and through special sessions, the GATT members directly supervise all GATT activities, including oversight of implementation of the Tokyo Round Codes and the Multifiber Arrangement. They have final say on dispute-settlement rulings and any other interpretation of GATT provisions. GATT decisions and rulings are adopted at meetings of the Contracting Parties or of the Council. In either case, GATT decisions are usually passed by consensus rather than by vote. The effect of consensus is that a country subject to a ruling can block its adoption.

[8] Contained in GATT art. I, the most-favored-nation principle sets forth the basis for nondiscrimination in commercial relations among GATT members—e.g., tariffs and other charges should be applied equally to products imported from all GATT members.

[9] Contained in art. III, the principle of national treatment aims to avoid the offsetting of tariff concessions by the manipulation of domestic measures. It requires that internal taxes be applied equally to domestic and imported products and that other domestic commercial regulations treat imported goods "no less favorably" than domestic goods.

[10] GATT art. II. The tariff that a GATT member has negotiated as a concession is called a binding and is the maximum tariff that it may impose on the product. A country's bindings together constitute a member's schedule of tariff concessions. These schedules are an integral part of the General Agreement. Volker, E.L.M., ed., *Protectionism and the European Community*, 2nd ed. (The Netherlands: Kluwer Law and Taxation Publishers [1987]). GATT art. XXVIII bis contains the authorization for the "rounds" of multilateral trade negotiations that GATT has sponsored from time to time since its inception.

[11] Addressed in arts. V through X.

[12] Contained in art. XI. Art. XII contains exceptions allowing the use of nondiscriminatory quotas when a country is undergoing balance-of-payments difficulties.

[13] Art. XVI also includes an exception whereby export subsidies on primary products are allowed as long as they do not enable a member to gain a "more than equitable share" of the world market in a given primary product.

[14] Contained in art. XIX, under which a contracting party may impose temporary tariffs or quantitative restrictions, on a MFN basis. Art. XIX also provides, however, that a contracting party taking such action must negotiate with trading partners to compensate them for imports affected by the safeguard action.

[15] GATT art. XII.

[16] GATT art. XX.

[17] GATT art. XXI.

the Tokyo Round of the MTN, GATT members negotiated six separate agreements, referred to as MTN codes, to set guidelines for the use of nontariff measures such as subsidies and countervailing duties, antidumping duties, import-licensing regimes, standards, government procurement, and customs valuation.[18] Some of these codes elaborate or expand upon obligations already contained in the General Agreement. Others, such as the Government Procurement Code, create new obligations. In all of these, only countries who have signed the individual agreements are bound by any obligations that go beyond those found in the General Agreement.

The GATT and Customs Unions

Article XXIV of the General Agreement addresses customs unions, as well as free-trade areas, and outlines the objectives the contracting parties seek to promote through their use. It also contains a definition of a customs union, the requirements it must meet, and the obligations of its members to contracting parties not included in the union. In allowing the formation of customs unions, the General Agreement points to the positive contribution they may make to achieving the broad objectives of the GATT. Article XXIV(4) recognizes the "desirability of increasing freedom of trade" through "closer integration between the economies of the countries parties to such agreements." Paragraph 4 also emphasizes that the purpose "should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."

The GATT definition states that a customs union consists of the formation of a single customs territory that satisfies two key elements.[19] The first is that members eliminate duties and other trade regulations on "substantially all trade" between them. The second is that each member applies the same duties and other trade regulations to other contracting parties.[20]

In effect, under article XXIV the contracting parties are willing to allow for the trade liberalization offered by such arrangements, even at the cost of departing from one of the GATT's main principles—MFN treatment of all contracting parties. Thus, article XXIV exempts GATT members who form a customs union from granting imports from other GATT members the same treatment granted one anothers' imports—treatment that the MFN principle would otherwise require. As one academic has noted, "The strict application of the MFN obligation would eliminate the possibility of GATT parties taking part in such an undertaking."[21]

Article XXIV Requirements and Obligations

Other provisions of article XXIV outline the requirements a customs union must meet and the obligations incurred with respect to GATT contracting parties that are not members of the union. The foremost requirement is contained in article XXIV(5), which states that the General Agreement shall not prevent the formation of a customs union "provided that . . . the duties and other regulations of commerce imposed" on trade with other GATT members "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union." The second condition is that any interim agreement leading to the establishment of a customs union or free-trade area must include a definite plan and schedule for achieving complete free trade among the members within a reasonable length of time.

Article XXIV(6) requires that if, in forming a union, a contracting party must increase the rate of certain bound duties, procedures of article XXVIII on modification of schedules shall be used to negotiate compensation. Article XXVIII procedures are discussed in further detail below. Countries who form a customs union are also subject to notification requirements. Under article XXIV(7) the GATT members are to be given prompt notice of an arrangement along with information that will enable them to make recommendations.[22] The usual practice is to establish a working party to review information on

[18] Three other sectoral agreements were also negotiated to cover trade in dairy products, bovine meats, and civil aircraft.

[19] Art. XXIV(8)(a) reads—

> (a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that,
>
> (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all trade in products originating in such territories, and,
>
> (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union.

(Par. 9 refers to the maintenance of certain preferences mentioned in GATT art. I(2) in effect between certain countries at the inception of the General Agreement.)

[20] A free-trade area must meet the first, but not the second, standard. In a free-trade area the members retain their own trade regime relative to outside countries.

[21] Volker, 1987, p. 22. Other exceptions to the MFN rule are found in the general and security exceptions of arts. XX and XXI, the general waiver provision of art. XXV(5), and the retaliation provision of art. XXIII.

[22] A rarely used additional provision, par. 10, allows the Contracting Parties to approve (by a two-thirds majority) aspects of an arrangement that do not otherwise comply with the art. XXIV requirements. This provision has only at times been employed to approve the participation of a non GATT member in a customs union or free-trade area. McGovern, Edmond, *International Trade Regulation: GATT, The United States and the European Community*, (Exeter: Globefield Press [1986]) p. 266.

the customs union and issue a report and recommendations for consideration by GATT members. The review process seeks to investigate whether an arrangement "conforms to the standards and conditions laid down in the article."[23] Paragraph 7(b) stipulates that, "The parties shall not maintain or put into force . . . such an agreement if they are not prepared to modify it in accordance with these recommendations."[24]

Past Experience with the EC and Customs Unions

The working parties set up to consider new arrangements often reach no consensus and the Contracting Parties take no action, withholding judgment rather than granting approval or disapproval regarding the GATT-consistency or trade impact of an arrangement.[25] This was the case at the formation of the EC customs union at a time when U.S. interests favored a stronger Europe and U.S. trade balances were in surplus rather than deficit. Some academics describe article XXIV as one of the "least successful in the General Agreement."[26] A GATT "wisemen's" report noted that many of the agreements notified under article XXIV fall short of its requirements and weaken trade rules.[27]

The Treaty of Rome, signed on March 25, 1957, established the European Economic Community. A review of the compatibility of the treaty with the General Agreement was performed by a GATT working party that began its work in late 1957. The four central issues were the Common External Tariff, EC quantitative restrictions, the Common Agricultural Policy, and the preferential trade relationships between the EC and several dependencies of the member countries.

The members of the EC maintained that the treaty was compatible with GATT. Their response to the GATT review was a stance in which they urged fellow GATT members to 'wait-and-see' whether problems would develop. They regarded the questions of GATT conformity as minor and agreed to work out any problems that might arise over time. Their approach was apparently accepted by the Contracting Parties, who "agreed to set aside the legal issues for the time being and to direct their attention to specific problems which might arise out of the application of the Treaty."[28] The result, therefore, was that "the question of the compatibility or incompatibility aspects of the Rome Treaty has not been pressed to a conclusion."[29] In fact, the Contracting Parties never issued a final ruling on the compatibility of the EC Treaty with GATT rules.[30]

A GATT working party also proved unable to reach conclusions regarding the recent accession of Spain and Portugal to the EC. In February 1986, the GATT Council set up a working party under article XXIV:5 to "examine, in light of the relevant provisions of the General Agreement, the provisions of the documents concerning the accession of Portugal and Spain." In October 1988, the report of the working party was adopted by the GATT Council. In its conclusions, the report noted that many members of the working party believed the "evidence pointed to higher duties being applied in the acceding countries after accession."[31] Some members of the working party also considered the incidence of "other regulations of commerce" to be more restrictive than before accession, particularly with respect to certain EC quantitative restrictions, and the application of the EC's Common Agricultural Policy to Spain and Portugal. The EC, however, argued that the Treaty of Accession was fully consistent with the General Agreement and that the accession of the two countries would result in substantial market opening. "Because of the divergent views expressed," the report concluded, "the working party was unable to reach agreed conclusions as to the consistency of the Treaty with the General Agreement."[32] The report was forwarded as a summary of those views, rather than with any specific determination or recommendations.

Seeking Redress for Adverse Effects of EC Integration

Although article XXIV working parties have not proved particularly successful in evaluating or modifying the terms of such trade arrangements, they are not the only recourse. As mentioned

[23] U.S. Department of State, *The General Agreement on Tariffs and Trade*, Publication No. 5813, Apr. 1955, p. 18.
[24] Recommendations of a working party gain legal standing only when formally adopted by the Contracting Parties.
[25] GATT, *GATT Activities 1984*, (1985), p. 38. This experience has not been unique to customs unions. Also, free trade areas notified under the provisions of art. XXIV have resulted in similar inconclusiveness. In a recent example, the working party set up to examine the consistency of the United States-Israel Free Trade Area Agreement with the GATT was unable to reach any conclusions. See, *GATT, GATT Activities 1986* (1987) pp. 66 to 67.
[26] McGovern, 1986, p. 262.
[27] In 1985, GATT Director General Arthur Dunkel appointed an independent panel of international trade experts to meet and report on the GATT system. Their conslusions were published in: GATT, *Trade Policies for a Better Future*, 1985, p. 41.
[28] GATT, *The Activities of GATT 1960/61*, (1961), pp. 15 to 16.
[29] Ibid.
[30] Parry, Anthony, and James Dinnage, *Parry and Hardy: EEC Law*, 2nd ed. (New York: Oceana Publications, Inc. [1981]) p. 173. The authors also argue that lack of a ruling does not mean "that the Community is to be considered to exist in any way in violation of GATT."
[31] GATT doc. no. L/6405, Oct. 5, 1988.
[32] Ibid.

briefly above, the General Agreement contains several avenues GATT members can use to seek removal of or compensation for actions taken by other members that violate GATT rules, that nullify or impair the value of a concession, or that adversely affect other benefits and objectives of the agreement. Available recourse includes provisions of article XXIV(6) on customs unions, article XVIII on the modification of tariff schedules, as well as consultation and dispute-settlement provisions of the General Agreement and the certain Tokyo Round codes. EC trading partners will be able to use such provisions to address their concerns about new policies or directives enacted under the EC market-integration exercise. Former U.S. Secretary of Commerce William Verity recently affirmed that, "The United States will resist any violation of our rights under the GATT or our bilateral treaties with European countries."[33]

Recently, the United States has invoked GATT provisions to counter two EC directives, one restricting imports of meat from animals treated with hormones, and one restricting the import of meat from foreign meatpacking plants subject to certain standards. The United States addressed the EC Hormone Directive by entering into bilateral talks under the auspices of the GATT Standards Code. The United States pursued its complaint about the directive on meat packing plants under GATT articles, by conducting bilateral GATT consultations and then requesting a panel under GATT article XXIII.[34]

Compensation Through Negotiations

For customs unions, the main elements of article XXIV(6) negotiations are (1) to determine whether any GATT bound tariffs have been altered, (2) to examine whether and to what extent trade is affected by the changes, and (3) to negotiate compensation, as appropriate. Paragraph 6 also provides that "due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union." This provision recognizes the possibility for "credit" when the establishment of a common tariff regime results in a tariff on a particular product that is higher than one country's previous level but lower than that of another member country.

Article XXIV(6) provides for increases in bound tariffs that result from the formation of a customs union to be renegotiated using article XXVIII procedures. Article XXVIII is the mechanism by which a contracting party may modify or withdraw tariff concessions and negotiate to compensate affected parties.[35] The article supports the principle of compensatory adjustment to maintain the integrity of commitments made in negotiations to reduce tariffs. Although the words "balance of concessions" do not appear per se in the General Agreement, the concept is frequently used today and appears in EC Commission statements regarding GATT consideration relevant to the integration plan.[36] In practice, as noted in the preceeding overview, article XXVIII and other GATT provisions support this concept by functioning so as to safeguard the "balance" of the concessions, rights, and obligations carefully negotiated among GATT members.[37] A contracting party wishing to exercise article XXVIII notifies the GATT when proposing to enter into such negotiations. The contracting party must enter into negotiations not only with the Contracting Party with whom the concession was initially negotiated, but also with those having a "principal supplying interest" and "substantial interest" in the tariff concession concerned.

GATT Dispute Settlement

When GATT member countries believe that a member has failed to respect a tariff concession or other obligation or has engaged in a trade practice inconsistent with GATT provisions, they can seek redress using the consultation and dispute-settlement procedures of GATT articles XXII and XXIII.[38] Under recent streamlining of GATT dispute-settlement procedures, complaints are being filed more frequently and dealt with more expeditiously than ever before.[39] Article

[33] Verity, C. William, then-Secretary of Commerce, "U.S. Business Should Prepare Now for EC 1992," New York, Oct. 18, 1988.

[34] For details, see U.S. International Trade Commission, *Operation of the Trade Agreements Program, 39th Report, 1987*, USITC Publication 2095, July 1988, pp. 4-7 through 4-9. The EC hormone ban went into effect on Jan. 1, 1989, triggering retaliatory tariff increases by the United States under sec. 301 authority of U.S. trade laws. Regarding meatpacking plants, by early 1988 EC inspection teams had certified over 100 U.S. plants for export to the EC but the U.S. Government is reserving conclusion of the dispute pending the certification of additional plants scheduled for inspection.

[35] Art. XXVIII provisions are used when a bound tariff rate is increased for any reason, including, for example, when a product is reclassified through administrative or judicial action.

[36] See, for example, the reference in the outset of this chapter to EC statements regarding "balance of mutual benefits."

[37] Art. XXVIII states that, "in such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products, the contracting parties concerned shall endeavor to maintain a general level of reciprocal and mutually advantageous concessions not less favorable to trade than that provided for in this Agreement prior to such negotiations."

[38] For further discussion, see U.S. International Trade Commission, *Review of the Effectiveness of Trade Dispute Settlement Under the GATT and the Tokyo Round Agreements*, USTIC Publication 1793, December 1985.

[39] In 1988, the GATT Council approved the establishment of a record number of dispute-settlement panels—14 in all and has handled many cases in 9 months or less.

XXII provides for general and rather informal bilateral consultations among parties on any matter affecting the operation of the General Agreement. If article XXII discussions do not resolve an issue, use of article XXIII(1) elevates the dispute to a more formal stage of consultations.[40]

If bilateral consultations fail to yield a mutually satisfactory solution, the matter may progress to consideration under article XXIII(2). It has become customary in using this provision for complaining parties to request a dispute-settlement panel. Once assured that the parties have exhausted bilateral efforts, the Contracting Parties (usually at meetings of the GATT Council) refer the dispute to a panel.[41] The panel reports its findings back to the GATT Council, which decides whether or not to adopt the report and its recommendations.[42] If adopted recommendations are ignored, the complaining country may request the Contracting Parties to authorize it to suspend "appropriate" concessions relating to the offending country, an action known as "retaliation."[43] However, such authorization has rarely been requested.

In the United States, resort to the dispute-settlement procedures of the GATT can be instigated by complaints from private parties in petitions filed with the Office of the United States Trade Representative (USTR) under the provisions of U.S. trade law known as "section 301."[44] The United States has frequently employed the dispute-settlement provisions of the GATT to address trade disputes between itself and the EC, often, but not exclusively, as a result of section 301 petitions from private parties.[45] The provisions of section 301 will continue to be available to the United States as a means to handle issues regarding EC actions if questions arise as to whether these actions are GATT inconsistent, discriminatory, or have other adverse affects.

Code Dispute Settlement

Many of the nontariff-barriers codes (discussed in further detail in subsequent sections of this chapter) also contain provision for consultation, conciliation, and settlement of disputes that arise between signatories. In cases where the codes address or elaborate on issues also covered in the General Agreement, they often do not preclude use of dispute settlement under GATT articles XXII and XXIII.

Past Experience with Compensation Efforts

In practice, customs unions are rare, and the only occasions under which GATT article XXIV(6) negotiations have been held were with the EC[46]. As with the current internal-market integration, negotiations overlapped with multilateral trade negotiations upon the formation of the EC and at the accession of the United Kingdom, Ireland and Denmark. Negotiations upon the accession of Spain and Portugal did not, however, and were elaborate, time consuming, and controversial.

Upon the EC's creation, other GATT members were entitled to compensation related to the enactment of the Common External Tariff. The Tariff Conference of September 1960 addressed the compensation issue. The EC started negotiations with other countries, but by May 1961, the representative of the EC "reported that they had exhausted their possibilities for negotiation and considered that the 'compensation' negotiations should be regarded as terminated, although in certain cases the EC had not achieved agreement with its negotiating partners."[47]

Another early attempt to gain compensation for an EC-wide change in policy resulted in the infamous "Chicken War" of the early 1960s.[48] In 1962, the EC adopted an EC-wide, variable-levy system on poultry. To do so, the EC withdrew a concession on poultry previously accorded by Germany. The measure virtually closed the

[40] Under art. XXIII(1), the affected country makes "written representation or proposals to the other contracting party or parties" concerned. When thus approached, a GATT member is required to give "sympathetic consideration to the representations or proposals made to it."
[41] The panel is composed of persons selected from the delegations of contracting parties not engaged in the dispute and sometimes of other expert individuals chosen from a roster of candidates compiled by GATT members. All panel members are expected to serve in their individual capacity acting as disinterested mediators rather than as representatives of their governments.
[42] Panel reports normally contain suggested remedies that the Contracting Parties may choose to adopt as recommendations to the disputing parties. Bilateral settlement among parties to a dispute is not discouraged and is possible at every phase of the process, even after the panel has completed its report and has issued a copy to the disputing parties. Once the Contracting Parties have adopted the panel report, however, the parties are expected to abide by the recommendations. Followup on the progress to implement those recommendations is conducted at subsequent meetings of the Council.
[43] According to the final paragraph of art. XXIII, after such suspension by the complainant, the offending country also has the right (within 60 days) to withdraw from the GATT.
[44] Ch. 1 of title III of the Trade Act of 1974, as amended, 19 U.S.C. 2411, et seq. Sec. 301 gives the USTR, "subject to the direction, if any, of the President," the authority and means to enforce U.S. rights under trade agreement and to otherwise respond to unjustifiable, unreasonable, or discriminatory foreign practices that burden or restrict U.S. commerce.
[45] U.S. resort to GATT dispute settlement does not require a sec. 301 petition, however, and can be taken by the U.S. Government on any issues deemed appropriate.
[46] McGovern, 1986, p. 265.
[47] GATT, *The Activities of GATT*, 1961/62, (1962) p. 9.
[48] For more details, see Evans, John W., *The Kennedy Round in American Trade Policy* (Cambridge, Mass: Harvard University Press [1971]) pp. 173 to 180.

EC to outside imports. The U.S. Government maintained that it was entitled to $46 million in compensation. The EC put the figure at only $13 million to $19 million. After much negotiating between the United States and the EC, the United States decided to resort to GATT to arbitrate an agreement. A GATT panel ruled that compensation in the order of $26 million was appropriate and recognized the U.S. right to withdraw tariff concessions in that amount. Following the panel report, and in accordance with procedures of article XXVIII, in January 1964 President Johnson imposed additional duties on products for which concessions had previously been granted to the EC.[49] The action effectively withdrew these concessions.

Upon the accession of Spain and Portugal to the EC in 1986, article XXIV(6) negotiations were undertaken between the EC and interested contracting parties.[50] The negotiations, to determine any compensation due to trading partners as a result of changes in bound tariff levels, were a source of considerable tension in U.S.-EC trade relations in 1986. These tensions reached a peak at which the United States threatened substantial trade retaliation (to be exercised under the terms of U.S. law rather than under GATT provisions for retaliation) if the compensation issues were not resolved. Most U.S.-EC issues related to compensation for enlargement were resolved bilaterally in early 1987. Under a complex agreement, the EC agreed, among other things, to assure certain levels of U.S. imports of disputed products and to lower tariffs on over 20 other products.[51]

Selected GATT Issues Relevant to EC Integration

Some of the public statements and directives already issued by the EC have raised questions about the application of certain of the GATT rules and principles that were described in the foregoing sections. A sampling of major GATT-related concerns about specific practices or principles emerging at this point in the EC 1992 exercise are explored in this section.

In recent policy statements, U.S. Government officials have expressed both general and specific problems with developments in the EC exercise. A U.S. Department of State briefing paper states that, "some potential areas of concern include protectionism, reciprocity, and transparency."[52] Former Secretary of Commerce Verity described three main areas of possible contention as reciprocity (particularly in banking and financial services), transitional measures on autos and textiles, and standards and certification issues.[53]

A Commerce Department publication raised concerns, based on statements by EC officials, that final EC legislation might include "limits on national treatment, reciprocity, requirements for third countries, local content requirements, or other restrictive provisions."[54] The U.S. private sector has also raised questions. A trade association spokesman listed several subjects of apprehension, including "quantitative restrictions, standards development, 'mutual recognition' of standards to 3rd countries, public procurement, state monopolies (will existing state monopolies be allowed to exist in some cartelized form in post-1992 Europe?), and company policies (How will an EC company be defined. . . . Will state subsidies be preserved?)"[55] Many of these issues fall into categories of practices that are covered by principles and provisions of the GATT. Some that do not now benefit from GATT coverage are under negotiation in the Uruguay Round with the hopes of expanding GATT's scope.

GATT Principles

Nondiscrimination

Articles I and III of the General Agreement together form the basis for the nondiscrimination requirements of the GATT. GATT members are called upon not to discriminate among trading partners (MFN treatment) or between the treatment of domestic versus imported products (national treatment). Although "reciprocity"[56] is not specifically defined in the General Agreement, the term "unconditional reciprocity" is usually used to describe the nondiscrimination requirements of the GATT.[57] As noted

[49] McGovern, 1986, p. 265.
[50] In addition to negotiations with the United States, the EC conducted such negotiations with other trading partners, including Japan, Canada, and Argentina.
[51] For further details on the agreement reached between the United States and the EC, see U.S. International Trade Commission, *Operation of the Trade Agreements Program, 39th Report, 1987*, USITC Publication 2095, July 1988, pp. 4-7 and 5-10.

[52] U.S. Department of State, *The European Community's Program to Complete a Single Market by 1992*, July 5, 1988, pp. 4 to 5.
[53] Verity, C. William, then-Secretary of Commerce, "U.S. Business Should Prepare Now for EC 1992," New York, Oct. 18, 1988.
[54] Lamoriello, Francine, "Completing the Internal Market by 1992: The EC's Legislative Program for Business," *Business America* (Aug. 1, 1988) p. 6.
[55] Hinson, J. Philip, U.S. Chamber of Commerce, "1992 Moves to Center Stage," October 1988.
[56] Art. XXVIII bis, that authorizes rounds of MTNs, calls for negotiations on a "reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports." The meaning of reciprocal is not defined and is subject to interpretation. For a more indepth treatment of the issues related to reciprocity and the European integration plan see the separate ch. 4 of this report, on reciprocity.
[57] A recent Congressional Research Service report notes: The principles enshrined in articles I and III are examples of "unconditional" reciprocity. Both the United States and the EC seem to be embracing a concept of more conditional reciprocity in some

previously, the EC has stated that in the external aspects of its new policies it will meet its international obligations, but will do so "in accordance with the balance of mutual benefits and reciprocity."[58] "In sectors where there are no multilateral rules," the EC says it will seek new international agreements but will negotiate bilaterally with its partners to obtain satisfactory access to their markets to compensate for the benefits EC trading partners may obtain from EC liberalization before new agreements exist.[59]

In spite of EC disclaimers, such pronouncements seem to imply that it will seek "sectoral reciprocity" rather than the "unconditional reciprocity" contained in GATT articles I and III.[60] These EC statements have prompted concern for two reasons. First, the EC call for reciprocity worries the U.S. officials "because of its potential to undermine multilateral trade liberalization in the Uruguay Round of the GATT. . . . [and] to undermine the national treatment provisions of article III of the GATT."[61] A U.S. Department of State briefing paper affirmed that "The United States . . . believes that national treatment should be granted unconditionally."[62] Second, some of the items "not covered by GATT" are currently subject to Uruguay Round negotiations to bring them under GATT rules. This fact raises questions about timing and possible conflicts between application of the EC directives and the outcome of the trade round. If the GATT succeeds in covering "new areas" by the conclusion of the Uruguay Round in 1990, it is unclear how EC directives calling for sector-specific reciprocity will conform to GATT principles such as national treatment that may be extended to, for example, services and trade-related investment measures.

Transparency

Contained in GATT article X, transparency in the publication and administration of trade regulations is another principle that trading partners are considering as the EC implements its new policy directives. The implementation of the 1992 program involves drafting, approving, and implementing nearly 300 directives and other policies. Although, "prior to their adoption, each directive is published and circulated for comment"[63] within the EC, it is not clear to what degree non-EC countries may make their interests known prior to a directive becoming a fait accompli. The U.S. Department of State has acknowledged that although the EC process seems to involve "transparent procedures, the concern is that third countries be allowed to review and comment on Commission proposal in a 'meaningful way.'"[64] Transparency is particularly relevant to the detailed and technical requirements for drafting directives on subjects such as standards and government procurement.

Safeguards

Safeguards provisions of the GATT may become relevant to the EC 1992 program as implementation begins to take its toll on some European industries that are currently protected that encounter transitional difficulties when facing global competition. Safeguards are addressed under article XIX of the General Agreement, also known as the "escape clause." It allows GATT members to escape temporarily from their negotiated GATT commitments and impose emergency, restrictive trade measures when actual or threatened serious injury to a domestic industry is demonstrated. Since article XIX provides that a concession may be suspended, withdrawn, or modified only "to the extent and for such time as may be necessary to prevent or remedy" the injury, the suspensions are of a temporary nature. A country exercising article XIX is required to notify the GATT and consult with affected exporting countries to arrange compensation. The incentive to negotiate stems from the right of affected countries to suspend unilaterally "substantially equivalent concessions or other obligations." Thus, if actions under article XIX are used by the EC to address short-term industry adjustment problems, the United States and other EC trading partners may be able to negotiate compensation for the effects on their trade for the duration of the measures.

Quantitative Restrictions and Other Nontariff Measures

Quotas

As mentioned above, the General Agreement allows quantitative restrictions only under the provisions of specific exceptions to the general ban on them contained in article XI. As it now stands, the U.S. Government considers present

[57]—*Continued*
instances, seeking for example a balance of the results (quantitative) in trade or an equivalency of results, rather than the overall "balance of obligations" implied in GATT articles I and III.
Harrison, Glennon J., *The European Community's 1992 Plan: An Overview of the Proposed "Single Market,"* Congressional Research Service, Sept. 21, 1988, p. 25.

[58] "External Aspects of the Large European Market: EC Commission Guidelines," *Europe Documents* 1530 (Oct. 25, 1988).

[59] EC, Information Memo, "Europe 1992: Europe World Partner," Oct. 19, 1988.

[60] The EC said that its call for reciprocity does not mean "that the Community is seeking sectoral reciprocity based on comparative trade levels, this being a concept whose introduction into United States legislation has been fought by the Community." EC, Information Memo, "Europe 1992: Europe World Partner," Oct. 19, 1988.

[61] Harrison, Sept. 21, 1988, p. 24.

[62] U.S. Department of State, *Western Europe Regional Brief,* November 1988.

[63] Harrison, Sept. 21, 1988, p. 25.

[64] U.S. Department of State, *The European Community's Program to Construct a Single Market by 1992,* July 5, 1988, p. 5.

EC members' national quotas on certain imports to be GATT-illegal. The concern is that these could be "replaced by Community-wide protections, at least for a transitional period."[65] U.S. Government officials such as former Commerce Secretary Verity have expressed dissatisfaction about quotas as a form of "transitional" or temporary protection of EC industries against outsiders.[66] Some EC member countries now use import quotas to protect such domestic industries as automobiles and textiles. If the EC Commission were to adopt measures "to provide 'temporary' protection to affected sectors. . . it would effectively extend trade restrictions from localized segments of national markets to the entire European Community."[67] The administration position is that GATT-illegal national requirements should not be expanded.[68]

Other nontariff measures

As one observer notes, "it was relatively easy for the Community to establish its policy with regard to tariffs."[69] The main thrust of the EC 1992 exercise is, however, to complete the integration that was initiated with the establishment of the common external tariff and the elimination of internal nontariff barriers. Also, with internal integration, the EC will harmonize internal trade regulations and apply a common set of nontariff measures[70] and trade regulations to non-EC member states. In doing so, the EC will have finally implemented measures to comply with the second half of the GATT definition of a customs union that requires that not only tariffs but also "other restrictive regulations of commerce" be eliminated among members of the union. Numerous articles of the General Agreement present the requirements that nontariff measures should satisfy to ensure that the aims of free trade are not frustrated. The Tokyo Round codes also cover nontariff measures. Many of the concerns raised by new EC policy statements and directives that have bearing on obligations with respect to nontariff barriers are discussed below. If EC trading partners believe any of the new EC measures do not conform to GATT obligations regarding nontariff barriers, dispute settlement and other forms of negotiation and debate under GATT auspices will be available to address the concerns.

[65] McPherson, Peter M., then-Deputy Secretary of the Treasury, "The European Community's Internal Market Program: An American Perspective," Remarks before the Institute for International Economics, Aug. 4, 1988.
[66] Verity, C. William, then-Secretary of Commerce, "U.S. Business Should Prepare Now for EC 1992," New York, Oct. 18, 1988.
[67] Harrison, Sept. 21, 1988, p. 24.
[68] Ibid.
[69] Parry and Dinnage, 1981, p. 449.
[70] The distinction between nontariff barriers and nontariff measures being that the former are trade restrictions and the latter are administrative necessities that do not necessarily restrict trade.

Tokyo Round Codes on Nontariff Barriers

The General Agreement has been supplemented by a number of other agreements.[71] Some of these are relevant to the changes under way in the European integration effort. The major categories of directives the EC has passed or is considering for its internal market program relate to the codes on standards, government procurement, and customs valuation. Adherence to the codes is optional, and not all GATT members have become signatories. Thus, to the extent that code rules and obligations surpass those of the General Agreement, they are only applied among those who have signed. The EC is a signatory to all of the codes. The EC and its trading partners will need to consider whether new EC measures in these areas conform not only to the General Agreement but also to provisions of the relevant codes. A brief discussion of issues that are important with respect to each of these three codes follows.

Standards

The Standards Code (formally the Agreement on Technical Barriers to Trade) was designed to address the problem of the barriers to trade that arise due to the existence of standards, technical regulations, and certification systems. The code clarifies general GATT principles by formulating rules on national and MFN treatment concerning standards and, to a lesser extent, certification systems by central-government bodies (art. 2, par. 1, and art. 7) It also contains a code of conduct on the introduction of new standards.[72]

Main features of the Standards Code.—The code does not attempt to eliminate all technical specifications acting as barriers to trade, to delineate standards for individual products, nor to set up specific testing and certification systems, since these activities fall within the scope of other institutions and organizations. Rather, it seeks to establish, for the first time, international rules between governments concerning the procedures by which standards and certification systems are prepared, adopted, and applied and by which products are tested from conformity with standards. The code also provides a vehicle

[71] Examples of other agreements that supplement or amend the GATT include those amending tariff schedules, pt. IV of the General Agreement on trade and development added in 1967, the Multifiber Arrangement covering textiles trade, and the three Tokyo Round codes covering trade in certain sectors.
[72] J. Steenbergen, "Agreement on Technical Barriers to Trade" in Volker, E.L.M., ed., *Protectionism in the European Community*, 2nd ed., (The Netherlands: Kluwer Law and Taxation Publishers, [1987]) p. 187, chapter entitled "The Implementation in the EC and the Application of the Agreements of the Tokyo Round."

through which signatories can work toward solutions for particular standards-related problems.[73]

Signatories to the code agree to (1) formulate standards that will be least disruptive to international trade but still achieve their essential public policy goals (e.g., protection of human health and safety and the environment); (2) provide "national treatment" to imported products as far as standards are concerned; (3) grant imported goods access to their certification systems (both regional and national); (4) use international standards as much as possible when formulating new standards or altering existing ones; (5) conform to a number of procedures, such as prior notification in order to ensure transparency; (6) establish so-called inquiry points where signatories can obtain information on standards maintained by that specific country; and (7) provide an opportunity for signatories to comment on proposed standards.[74] The key code issues of concern to the United States regarding the 1992 exercise have to do with the effectiveness of existing coverage of the code (in the area of regional standards bodies and testing and certification) and national treatment.

The EC's regional standards and the code.—As discussed in chapter 7, part II of this report, as part of the 1992 exercise the EC has shifted the emphasis of its standards-drafting activities from the national to the regional level. Specifically, responsibility for developing EC standards considered "essential" from a public policy point of view will, in many cases, be delegated by the EC Commission and member states to regional standardsmaking bodies, such as CEN and CENELEC.

Presently, signatories to the code are bound only to "take such reasonable measures as may be available to them" to ensure that regional bodies of which they are members comply with the appropriate transparency provisions of the agreement. As defined in the agreement, a regional body or system is one whose membership is open to the relevant bodies of only some of the Contracting Parties. Articles 2.9, 2.10, and 9 of the code were drafted to deal with the possibility that nonmembers would be denied their right to equal treatment under the code as a result of regional activities.[75]

U.S. officials are of the view that if standards are substantially evolved regionally, their notification to the GATT is essentially pro forma.[76] Comments on proposed standards from other signatories cannot, in reality, be taken into account because a consensus has been reached among the members of the regional organization. Furthermore, monitoring signatories' reliance on regional standards is difficult since technical regulations are notified at the time they are proposed for implementation at the national level and notifications do not usually reference the regional standard or certification system.

Previous code discussions regarding regional standards.—In fact, concern about exclusive European arrangements was reportedly a primary impetus for negotiation of the code. U.S. manufacturers were concerned that a proposed French-British-German tripartite certification system (the CENEL Agreement) would create a nontariff trade barrier by preventing products originating in countries that were not members of the regional bodies from being certified for sale in the market of the member countries. Concerns regarding access to regional certification systems have been supplemented with concerns about standards development by regional bodies. Since regional standards serve as the basis for regional certification systems, the technology they incorporate becomes the key to whether or not a product is certified. The United States reportedly also feared that a concentration by Europeans on the development of "European," rather than international, standards would undermine the international standardization work of such bodies as the ISO (International Organization for Standardization) and the IEC (International Electrotechnical Commission). The United States is often out-voted in the ISO by a bloc of European countries that are members of CEN and CENELEC.

The discussion of activities of regional bodies and the desire for further understanding of their activities led the United States to initiate a proposal in the first "three-year review" of the code that representatives of regional bodies make presentations to the code committee on their procedures and how they related to those embodied in the agreement. The proposal was adopted.

[73] U.S. Department of Commerce, International Trade Administration, *Agreement on Technical Barriers to Trade: A Descriptive Summary*, p. 2.
[74] Robert M. Stern, John H. Jackson, and Bernard M. Hoekman, *An Assessment of the Implementation and Operation of the Tokyo Round Codes*, ch. 5, p. 41.
[75] Art. 2.9 requires signatories to use their "best efforts" to ensure that regional standardizing bodies conduct their activities using open procedures. Art. 2.10 states that if such procedures have not been used by a regional body, a signatory adopting a regional standard must itself use open procedures. Art. 9.3 requires signatory governments to ensure that regional certification bodies provide access to certification system—the ability to obtain certification and receive the certification mark with non discriminatory treatment. In addition, provisions of art. 10 require the inquiry points established by the agreement to be able to respond (or make appropriate referrals) to inquiries regarding the activities of regional standardizing or certification bodies in which bodies in a signatory country participate.
[76] The discussion that follows is based on material provided by the Office of the USTR.

In the agreement's second "three-year review," the United States circulated a proposal that—

> "Parties be required to ensure that regional standardizing bodies of which they are members adopt transparency provisions consistent with their obligations as Parties to the Agreement."

This proposal was not adopted. The EC stated that it is not answerable to the Code Committee on this issue because participation in standardsmaking bodies is not treated in the code, and it suggested that this issue be addressed in the Uruguay Round.

In the course of discussing the proposal, differences in views concerning the activities of such bodies were revealed. On the one hand, the development of standards by regional bodies can be viewed as trade liberalizing to the extent that requirements are harmonized among their members. Some parties view the development of regional standards when no international standards exist as a step toward the development of an international standard. On the other hand, the development of standards by regional bodies when no international standard exists, or when the regional standard differs significantly from an existing international standard, can be viewed as protectionist or trade inhibiting.

It is clear that regional bodies themselves are not subject to the code's provisions; only signatories that are members of such bodies must comply with the code. It is the view of the United States that the effect of the "best efforts" language has been woefully inadequate regarding the procedures for notification, publication, submission of comments, discussion, and taking comments into account.[77]

Testing and certification.—The second issue has to do with testing and certification. Facilitating the mutual acceptance of test data and reducing the unnecessary costs of duplicative testing and approval procedures were identified by the United States as key areas for improving the Standards Code in 1985 during the code's "third year review." The following year, the committee agreed that any testing and inspection procedures carried out by members should be based on the principles and rules of internationally recognized "guides" on laboratory accreditation issued by the ISO and the IEC. In 1987, the committee adopted a U.S. proposal recommending that members provide information on steps taken to implement these principles and rules on their inspection, and testing activities. Several members presented information on the implementation of these "guides" in their countries. The subject of testing, inspection, and type approval will continue to be discussed during the Uruguay Round.[78]

National treatment.—Finally, there is apparently some ambiguity regarding the code's national-treatment clause. The question is whether the EC's rules on the free movement of goods and the application of standards, such as that developed in the Cassis de Dijon ruling and endorsed in the 1985 White Paper, should be applied to all parties to the code, pursuant to its national-treatment clause.[79] J. Steenbergen writes that the answer to this question is "complicated by a long standing dispute on the division of powers between the Community and the Member States in the field of technical standards." The code is signed jointly by the EC and the member states, which Steenbergen states, "makes it very difficult to know whether the Community is to be considered as a single market or party for the purpose of application of the Code, or whether each of the Member States are individually bound by the agreement in the same way as each of the other parties."[80]

Government Procurement

The Government Procurement Code (formally known as the Agreement on Government Procurement) entered its eighth year of operation in 1988.[81] Negotiated during the Tokyo Round, the code was designed to eliminate one of several nontariff barriers to market access for companies competing abroad. The primary obligation of the code is that signatories will not discriminate against or among the products of other signatories in purchases subject to the code. Specifically, signatories to the Government Procurement Code agree to provide firms from other code signatories with national treatment and nondiscrimination in specified purchases and to establish common and more transparent procedures for providing information on

[77] As required of signatory governments under art. 2, pars. 1 to 8, for technical regulations and standards of central government bodies; and art. 7 (with the exception of 7.2, which is covered by 9.3) for certification systems operated by central-government bodies. For these reasons, the United States has suggested transparency in regional activities as an area for improvement in the Standards Code through the Uruguay Round negotiations on MTN agreements and arrangements.

[78] U.S. International Trade Commission, *Operation of the Trade Agreements Program, 39th Report, 1987,* USITC Publication 2095, July 1988, p. 2-23.

[79] For details see ch. 6.

[80] J. Steenbergen, "Agreement on Technical Barriers to Trade" in Volker, E.L.M., ed., *Protectionism in the European Community,* 2nd ed., (The Netherlands: Kluwer Law and Taxation Publishers [1987]), pp. 187 to 190, chapter entitled "The Implementation in the EC and the Application of the Agreements of the Tokyo Round."

[81] Code signatories are Austria, Canada, Finland, Hong Kong, Israel, Japan, Norway, Singapore, Sweden, Switzerland, and the United States. The European Community is the signatory on behalf of the member states.

proposed purchases, opening and awarding bids, and settling disputes.[82]

The code is essentially a two-part document setting forth coverage and procedures. The code's coverage extends to purchases of goods by specified government entities (e.g., ministries and departments) listed in annexes to the code.[83] The code does not apply to procurement of services (except those incidental to the purchase of goods), construction contracts, national security items, purchases by State and local governments (with or without Federal funds), or purchases by any entity that has not been specified as being covered.[84]

To eliminate discrimination against foreign products at all stages of the procurement process, the code includes detailed requirements on how government purchasing is to be conducted. Signatories must openly publish invitations to bid on all contracts, supply all documentation necessary to bid, apply the same qualifications and selection criteria to both domestic and foreign firms, and generally provide full information and explanation at every stage of the procurement process. Signatories are permitted to purchase using one of three procedures—open tendering, restricted tendering, or, in exceptional circumstances, single tendering.[85] The code also includes dispute-settlement provisions.

[82] International trading rules had heretofore permitted governments to maintain restrictive "buy national" policies. Art. III of the GATT specifically states that GATT rules restricting the use of internal regulations as barriers to trade do not apply to "procurements by governmental agencies of products purchased for government purposes." In some countries, such as the United States, these policies have taken the form of clearly stated preference margins for domestic goods. In other countries, national policies are carried out through less formal but often more restrictive means.

[83] This list includes almost all the central-government entities of the major developed countries, covering contracts valued at 130,000 Special Drawing Rights (SDRs), or about $150,000.

[84] The United States has also specifically provided that purchases under its small and minority business set aside programs will not be subject to the agreement's provisions.

[85] Under open tendering, any interested firm may bid. Under selective tendering, suppliers on a list of qualified bidders are invited to bid. In this latter instance, all qualified bidders from signatories must be included on bidders list upon request, and selections from the bidders list must provide full opportunity for foreign bidders to compete.

To promote its continued effectiveness the code stipulated that within 3 years of its entry into force, the signatories would commence negotiations to expand the code's coverage to purchases that were not initially covered, including leasing and service contracts. The first phase of the renegotiations, under code article IX: 6(b), lasted until 1986 and was implemented on February 14, 1988. The 1986 agreement amended code procedures to require more competition and expanded coverage somewhat by including leasing contracts and lowering the contract value threshold from 150,000 Special Drawing Rights (SDRs) to 130,000 SDRs or about $150,000.[86]

Under the Government Procurement Code, U.S. suppliers already have the right to compete on an equal footing with EC suppliers for most central-government purchases of goods and services incidental to the supply of goods.[87] "Excluded sectors" and services per se do not now benefit from code coverage, however. This means that the EC is not currently obliged to ensure U.S. suppliers' access to such contracts, nor to follow the code's requirements for transparency and nondiscrimination in procurement practices in such purchases. Discrimination against U.S. suppliers in these sectors would not provide grounds for formal dispute settlement in the GATT or the Government Procurement Code. However, extension of the code to the "excluded sectors" and services is presently under discussion in the context of phase two of the renegotiation of the code. These discussions have been folded into the Uruguay Round and are discussed in detail in the following chapter.

[86] Mike Merin, Office of Multilateral Affairs, U.S. Department of Commerce, "Government Procurement Code Negotiations Near Critical Phase," *Uruguay Round Insider* (November 1988).

[87] GATT Government Procurement Code signatories will automatically qualify for the broadened coverage of the revised "supplies" directive (i.e., by virtue of the narrower definitions of "exclusions"). USITC field interview with the DG III, Commission of the European Communities, Feb. 27, 1989.

CHAPTER 15
EC INTEGRATION AND THE URUGUAY ROUND

CONTENTS

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EC Integration and the Uruguay Round

Overview

To encourage the progressive liberalization of trade, GATT members have participated in seven rounds of multilateral trade negotiations and are now engaged in the eighth round, known as the Uruguay Round. A meeting of GATT trade ministers held in Punta del Este, Uruguay, on September 15 to 20, 1986, launched the Uruguay Round of Multilateral Trade Negotiations. The resulting Ministerial Declaration scheduled 4 years of negotiations ending in 1990. In addition to negotiating liberalization of tariff and nontariff measures, participants are considering proposals to improve the GATT rules, notably those covering agriculture, subsidies, safeguards, dispute settlement, and nontariff measures.

As it now stands, the GATT system does not cover trade in services or adequately address investment measures and intellectual property protection. Increasing resort to nontariff barriers, substantially greater volumes of trade in services, and a heightened awareness of effects on trade of investment measures and intellectual property rights have prompted a determination to expand GATT's coverage. Accordingly, in the Uruguay Round trade negotiators are also working to conclude rules to bring the "new areas" of services, trade-related investment measures, and trade-related aspects of intellectual property rights within GATT's scope.

In a recent speech, Willy de Clercq, EC Commissioner for External Relations and Trade Policy, summed up the importance and major objectives of the Uruguay Round:

> The Uruguay Round marks the transition to a new, broadened multilateralism. It represents a determined attempt to revitalize our institutions and the international trade system, on the basis of expanded and liberalized trade, and to allow it to cope with new developments. The traditional areas of trade negotiations such as tariffs and nontariff barriers, the particular concerns of developing countries, and trade in agriculture, are of course an integral part of the Uruguay Round. But we are now building into the complex equation of multilateral trade new subjects: trade in services, trade related investment issues, and intellectual property. We are also looking closely at the functioning of the GATT system and attempting to establish a much greater degree of coherence in policy-making in the nexus of monetary, financial and wider macroeconomic and trade sectors.[1]

[1] De Clercq, Willy, EC Commissioner for External Relations and Trade Policy, "The European Community's Place in a Multilateral World," Speech to the World Economic Forum, Geneva, Nov. 14, 1988.

The global determination to address tariff and nontariff barriers and to expand rules to cover issues beyond trade in goods is paralleled in the 1992 internal market integration exercise. Having already accomplished the elimination of internal tariffs, the EC's program will progressively eliminate other frontier barriers, harmonize trade regulations, and reduce nontariff barriers and other commercial restrictions affecting trade in both goods and services. The EC also hopes to enhance investment opportunities among EC member countries. However, the EC is pursuing this path just as GATT members are addressing many of the same issues on a global scale.

Efforts to reform the GATT involve significant areas of overlap with developments in the EC plan. Although the goals of both the GATT and the EC exercises offer positive signs for international trade liberalization, it is unclear to what degree the initiatives will reinforce one another or will conflict. For example, the objectives of the Uruguay Round will be blocked if EC policies move in the direction of protectionism toward non-EC countries or disregard Uruguay Round initiatives and GATT rules.

The Negotiating Process

GATT trade ministers set up a special administrative structure to administer the Uruguay Round negotiations. The Punta del Este Ministerial Declaration established a Trade Negotiations Committee (TNC) that began meeting before the end of 1986 to coordinate negotiating activities. The TNC is responsible for oversight of every aspect of the negotiations. Also formed were a Group of Negotiations on Goods (GNG), a Group of Negotiations on Services (GNS), and a Surveillance Body to oversee Ministers' commitment to a standstill and rollback of protectionist measures. All three groups report to the TNC. Fourteen topical negotiating groups report to the GNG; the GNS and the Surveillance Body do not have subgroups.

The midpoint of the Uruguay Round of multilateral trade negotiations was marked by a ministerial-level meeting of the TNC in December 1988 in Montreal, Canada. Trade Ministers from nearly 100 countries gathered at the midterm review to evaluate the progress of the trade round. The meeting aimed to provide the political momentum to keep the Uruguay Round on track and approve guidelines for negotiations over the remaining 2 years. Ministers reviewed texts of guidelines, agreements, negotiating frameworks, and progress reports submitted by the 15 negotiating groups.

At the December meeting, the ministers were in agreement on texts provided by 11 of the 15 groups. On tropical products, negotiators had successfully completed a package of trade

concessions prior to the meeting. Notably, texts were finalized on such topics as services, tariffs, dispute settlement, and functioning of the GATT system. Discussions on services resulted in a framework to guide further negotiations that would aim, for the first time, to extend GATT principles such as transparency, national treatment, and nondiscrimination to trade in services. Negotiators laid out a framework for tariff negotiations in which Ministers agreed to begin negotiations no later than July 1, 1989, to aim for a global 30-percent cut in tariff levels.[2] Ministers agreed to procedures to improve GATT's ability to settle trade disputes and to enhance the functioning of the GATT through more systematic surveillance of trade policies.

Due to the inability of the United States and the EC to agree on a negotiating plan to liberalize trade in agriculture, participants could not agree to the full package of negotiating plans in December. Agriculture was the most controversial but not the only area of disagreement; others included intellectual property, safeguards, and textiles. As a result, 11 of the 15 negotiating topics received preliminary approval but final adoption of the entire package was postponed. The package was approved at an April 1989 meeting in Geneva at which trade ministers succeeded in resolving their differences on the four outstanding issues. Each of the topical negotiating groups will continue to hold rounds of negotiations until the completion of the round, slated for 1990.

General Implications for the Uruguay Round

Although some issues under negotiation in the Uruguay Round are being addressed in Europe 1992, others are not. Where overlap does occur, each negotiating exercise will affect the timing, substance, and process of the other. Uruguay Round topics that are also subject to initiatives in the single-market exercise include expanded government procurement coverage, intellectual property rights, investment, and services. For such overlapping topics, the concern is whether inconsistencies will arise between decisions made in Brussels and the agreements being sought in Geneva. In every aspect of the internal market exercise, however, the United States will be urging the EC to seek nonrestrictive and nondiscriminatory decisions. In conjunction with the means available under GATT rules on customs union and dispute settlement, the United States can approach the Uruguay Round as an added opportunity to apply pressure on the EC to ensure that its internal program conforms to the multilateral system.

[2] GATT, *GATT FOCUS* 59 (January 1989) p. 2.

The single-market exercise is likely to have varying effects on Uruguay Round initiatives. Some EC directives, such as those on government procurement, may reinforce EC positions in the Uruguay Round. In standards discussions, the EC has argued that the internal process needs to be completed before it can fully engage in multilateral negotiations.[3] Such an approach could slow progress of the Uruguay Round. In a number of other areas, it is not yet clear whether the European exercise will reinforce or conflict with Uruguay Round negotiating objectives.

Advantages and Disadvantages

The fact that the EC effort and the Uruguay Round transpire at the same time raises problems in itself. With the Uruguay Round scheduled to finish by 1990, the Europeans have already passed many of their new directives, leaving only a few controversial directives and policy decisions to be completed by the 1992 deadline. For the Europeans, the issues and impact of the integration program are more immediate, thus EC countries appear to be devoting first priority to efforts on this program rather than to their interests in the Uruguay Round. The timing of the 1992 process also means that certain policies and directives may already be fait accompli[4] when related issues arise in the Uruguay Round, perhaps leaving little room for negotiating flexibility.[5] Also, with European countries focusing on internal matters, their Uruguay Round positions may reflect their internal politics more than their global interests.

Because of expanded EC Commission authority, the unified internal market may offer some advantages to trade negotiators seeking to achieve consensus in the Uruguay Round. On

[3] This is the approach the EC took on the Common Agricultural Policy (CAP). During the Dillon Round, the six members of the Common Market "had not yet agreed among themselves on the Common Agricultural Policy (CAP) foreseen for the more basic products such as grains, meats, and dairy items. They declined, therefore, to bind any tariff rates on about one third of their agricultural imports from the U.S." Evans, John W., *The Kennedy Round in American Trade Policy*, (Cambridge, MA: Harvard University Press [1971]) p. 137.

[4] A previous example of fait accompli occurred in the Kennedy Round. The United States tried to negotiate with the EC on their Common Agriculture Policy (CAP). After several delays and many proposals and counterproposals, "the parties finally got around to negotiating on the basis of the CAP as an established fact." Hudec, Robert E., *The GATT Legal System and World Diplomacy*, (New York: Praeger Publishers [1975]) p. 203.

[5] When the GATT negotiations were being conducted on the Treaty of Rome, it soon became apparent that the treaty was to be accepted in total or not at all. Since the initial negotiations on the formation on the EC were long and arduous, the possibility of reopening the package was slight. "Consequently, the Treaty of Rome and its basic commercial understanding had to be accepted as they were, or not at all." Hudec, 1975, p. 196.

many issues non-EC negotiators will be able to deal with one central EC authority, whereas previously they had to consult with each EC country individually. The Uruguay Round negotiating process may also benefit if the strengthened EC Commission can more easily arrive at internal consensus on a unified position for multilateral negotiations.

The internal market exercise also harbors potential disadvantages for the progress of multilateral negotiations. Some of the European changes will require substantial national economic adjustment. The concern noted by former Deputy Treasury Secretary McPherson is that "the adjustment pressures caused by the elimination of internal barriers to trade and investment could make the EC Commission and the member states less willing to liberalize external barriers in the Uruguay Round."[6] Also, an expanded central EC authority may have its drawbacks for negotiations. For example, bilateral channels might become unavailable or less effective as a means for U.S. negotiators to build consensus on certain Uruguay Round negotiating topics. With its new authority untested, the Commission may lack flexibility to adapt easily to changing negotiating positions or offers. In areas where authority is still shared between the EC and the member states, trading partners may have difficulty understanding the common EC position or determining whether to negotiate on a bilateral basis or directly with the EC Commission.

Negotiating Strategies

A foremost concern regarding the EC's participation in multilateral negotiations is that the EC may want to claim "credit" or compensation in the Uruguay Round for any liberalizing effects of market integration. Negotiators also fear that the EC may resort to reciprocity if such credit is not forthcoming, a position that could seriously sidetrack the round. This view is aroused by EC statements that appear in official briefings. One example states—

> The Commission reserves the right to make access to the benefits of 1992 for nonmember countries' firms conditional upon a guarantee of similar opportunities—or at least nondiscriminatory opportunities—in those firms' own countries.[7]

U.S. officials have publicly responded with warnings to the EC on this score. In the words of former Commerce Secretary Verity, "We have to resist those in the EC who want to treat every market-liberalizing step as a potential negotiating chip to be used bilaterally or in the Uruguay Round. . . The United States paid a price in negotiations when the Common Market was created 30 years ago. We can't be asked to pay all over again."[8]

Will the EC use its internal market measures as negotiating leverage? Some think that it will. A U.S. State Department brief observed, "Some in the Community want to use the benefits of the program as negotiating leverage to open up foreign markets." It also cautioned that, "The EC could adopt some measure of 'overall reciprocity' based on the degree of market access provided EC firms in specific foreign markets or the magnitude of the concessions offered by individual foreign countries in the current multilateral trade negotiations under the GATT."[9] These concerns of U.S. officials are also based on statements issued in EC Commission guidelines. One EC publication explains—

> In sectors where there are no multilateral rules, the Community will endeavor to obtain greater liberalization of world trade through negotiation of new international agreements. The Uruguay Round negotiations provide an opportunity here which the Community will seize. It would be premature, however, to grant non-member countries automatic and unilateral access to the benefits of the internal liberalization process before such new agreements exist. Noncommunity countries will benefit to the extent that a mutual balance of advantages in the spirit of the GATT can be secured. The Community may thus have to negotiate bilaterally with its partners in order to obtain satisfactory access to their markets.[10]

The EC insistence that reciprocity policies will only apply to sectors in which no rules exist prior to the conclusion of new GATT agreements begs the question. It can only raise doubts about the EC's commitment to seeing agreements on new areas take shape. This concern is particularly noteworthy since texts agreed upon at the Montreal midterm review already indicate that in services, for example, negotiators intend to include national treatment, not reciprocity, in the proposed services framework.

Standstill and Rollback Exercise

One forum in which Uruguay Round negotiators have already begun to address EC internal market issues is in the Surveillance Body. This body oversees the Uruguay Round standstill and rollback commitments. The EC and its trading partners have entered into consultations regarding certain EC measures.

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[6] McPherson, Peter M., then-Deputy Secretary of the Treasury, "The European Community's Internal Market Program: An American Perspective," Remarks before the Institute for International Economics, Aug. 4, 1988.
[7] "External Aspects of the Large European Market: EC Commission Guidelines," *Europe Documents* 1530, Oct. 25, 1988.
[8] Verity, C. William, then-Secretary of Commerce, "U.S. Business Should Prepare Now for EC 1992," Speech delivered in New York, Oct. 18, 1988.
[9] U.S. Department of State, "Western Europe Regional Brief," November 1988.
[10] "External Aspects of the Large European Market: EC Commission Guidelines," *Europe Documents* 1530, Oct. 25, 1988.

In March 1988, the United States and the EC entered into rollback consultations regarding a wide range of quantitative restrictions on agricultural and industrial products that the United States listed in a rollback request to the EC. The concept of rollback is applicable to the removal of GATT-illegal measures for which trading partners should not be expected to grant concessions,[11] whereas exchanges of concessions would be appropriate in other negotiating groups. Accordingly, the United States included quotas that it considers GATT-illegal in its rollback request to the EC. Also, the EC has submitted to the Surveillance Body a "conditional" offer to rollback quantitative restrictions on a number of products.[12] However, the EC submission did not include some of the quotas of concern to the United States. Furthermore, the offer was conditioned upon others' participation in rollback efforts, i.e., "that the offer would be confirmed in the light of similar contributions from other participants."[13]

Europeans, however, have made reassuring public statements that indicate that the rollback and standstill commitments are taken seriously. Some members of the EC may even consider the commitments a mechanism that allows it to "hold the line" against agruments from members of the EC seeking EC-wide protection against nonmember countries. One statement by the Confederation of British Industry observed that, "in many cases, the choice of options will be constrained by the EC's international commitments, such as the 'standstill' agreement on trade barriers accepted at the outset of the current Uruguay Round of GATT negotiations."[14] Also, an EC Commission brief noted that, "the EC has begun the process of rolling back by offering in the Uruguay Round to drop national import quotas on a range of goods," and asserted that, "this process will continue as the round progresses."[15]

Relevant Uruguay Round Negotiating Topics

The Uruguay Round encompasses 15 different negotiating groups, each of which is assigned to undertake negotiations of the topics mandated by the Punta del Este Ministerial Declaration. The topics covered are tariffs, nontariff measures, agriculture, services, intellectual property rights, investment, dispute settlement, tropical products, natural-resource based products, textiles and clothing, GATT articles, safeguards, MTN agreements and arrangements, subsidies and countervailing measures, and functioning of the GATT system. Negotiations on some of these topics are more directly relevant to activities under way in the European integration effort than others. Accordingly, the topics that follow were singled out for discussion in this section, either because they deal with GATT provisions with bearing on customs unions and integration efforts generally or because they deal with subject matter addressed in some of the 1992 directives discussed elsewhere in this report.

GATT Articles

Whereas many negotiating groups address substantive trade issues in which GATT's competence is drawn from GATT articles, the negotiating group on GATT articles is responsible for examining and improving the rules themselves. The aim is to improve both the effectiveness of and compliance with the rules. By the end of 1988, the group's report to the midterm review session stated that proposals had been tabled and discussed regarding 12 different articles of the GATT and the Protocol of Provisional Application. Among the rules under discussion are those covering customs unions and free-trade areas (art. XXIV). Negotiators have questioned the inadequacies of these rules for causing unintended discrimination among contracting parties and for failing to promote adequate review of GATT consistency to such agreements.[16] In addition, the group discussed the need to strengthen article XXVIII procedures for renegotiation of tariff concessions. As noted above under "The GATT and Customs Unions," article XXIV(6) calls upon customs unions to negotiate compensation with affected trading partners under the procedures of article XXVIII.[17] As a result, this group's negotiations could have impact on how the GATT review of European integration will be handled and how compensation negotiations will be conducted if the rules are changed before the internal market negotiaions start. The EC is likely to be vigilant about changes that will affect it with such immediacy.

Safeguards

As noted in the previous chapter, safeguards actions under GATT article XIX are one means the EC may be able to utilize to remedy short-term adjustment problems by industries as a

[11] Ministerial Declaration of the Uruguay Round, Sept. 15 to 20, 1986, Pt. I.C.(i) and (iii).
[12] Many of the quotas on the EC list are ones expected to be removed under the auspices of the 1992 program.
[13] GATT, *GATT FOCUS* 54, (April/May 1988) p. 8.
[14] Confederation of British Industry, "The implications of EC policy for quantitative restrictions on imports from third countries," Brief No. 8, annex, November 1988.
[15] "Europe without Borders: Answers to some Questions," *Europe*, October 1988.
[16] GATT, *GATT FOCUS* 55 (June/July 1988), pp. 6 to 7.
[17] On art. XXVIII, negotiators have discussed refining the meaning of "principal supplying interest" and "substantial interest," terms used to indicate which suppliers have the right to participate in the compensation.

result of new EC measures. The outcome of Uruguay Round negotiations, then, may be relevant to such EC actions and to the corresponding compensation that trading partners may seek. The negotiations on safeguards[18] seek a comprehensive agreement that will reinforce the multilateral discipline of the General Agreement over emergency actions. Punta del Este Ministerial Declaration directed negotiators to work toward reinforcing article XIX discipline and elaborating on issues such as transparency, criteria for action such as serious injury, digressivity,[19] structural adjustment, compensation and retaliation, and means for notification, consultation, surveillance, and dispute settlement. These basic elements were also discussed in inconclusive safeguards negotiations during the Tokyo Round and again during the early 1980s.[20] Safeguards talks remain difficult. When the trade ministers met at the December midterm review of the Uruguay Round, they could not agree to the text of the negotiating plan.

Although a compromise allowing work to go forward was reached in April meetings, no consensus emerged on specific means to strengthen article XIX. Many elements of safeguards negotiations are not controversial, but points of disagreement remain regarding, for example, selectivity and grey-area measures. Debate on selectivity centers on whether to allow safeguard actions to single out certain countries' imports or continue the current nondiscriminatory practice.[21] Debate on grey-area measures (safeguard-like actions—usually in the form of voluntary export arrangements—taken without using GATT procedures and thus outside multilateral controls) focuses on whether to allow grey-area measures to be taken and brougt under multilateral scrutiny, or to require that they be eliminated. The EC already has a number of voluntary export arrangements in place. If the EC considers further use of such measures following the implementation of 1992, the Uruguay Round negotiations to bring grey-area measures under GATT coverage will be an issue its trading partners may consider.

[18] Safeguards, or emergency actions taken under GATT art. XIX, are also addressed in the preceeding chapter of this report on "EC Integration and the GATT."

[19] The term "digressivity" refers to the principle that safeguards measures should be enacted so as to be progressively reduced over time.

[20] For Tokyo Round discussions, see U.S. International Trade Commission, *Operation of the Trade Agreements Program, 31st Report, 1979,* USITC Publication 1121, p. 54, and *34th Report, 1982,* USITC Publication 1414, p. 17. The 1982 Ministerial Declaration directed that a comprehensive understanding on proposed safeguards be presented to the Contracting Parties in 1983. This effort failed primarily because of fundamental disagreement over concepts such as selectivity and grey area measures. *See Operation of the Trade Agreements Program, 34th Report, 1982* pp. 74 to 75, *35th Report, 1983* p. 59, *37th Report, 1985* pp. 47 to 48.

[21] Some countries have long argued that GATT safeguards provisions would be more effective and better adhered to if the measures could be taken selectively against those countries mainly responsible for import surges. This is not currently allowed under GATT article XIX, which requires nondiscriminatory, global restraints.

Nontariff Measures

In the Uruguay Round negotiations on nontariff measures, the central aim, like that in tariff negotiations, is to liberalize global market access by negotiating to reduce and eliminate quantitative restrictions and other nontariff barriers. Trade negotiators had achieved agreement on a work plan on nontariff measures by the Montreal Midterm Review. The work plan envisions the start of detailed negotiations by June 1989 that will be modeled after the concession swapping associated with tariff negotiations. The plan allows for flexibility in the use of negotiating techniques.[22] One technique consists of request/offer negotiations to agreed-upon reduction or elimination of specific barriers. Another technique is a formula-based approach to reducing barriers. The potential for overlap between this group and a number of other Uruguay Round negotiating groups is great. Some debate in the negotiating group has focused on whether the group should be limited only to work on nontariff barriers not already covered in other negotiating groups or whether it should remain open to discussion on any nontariff barriers negotiators wish to raise. For this reason, a restrictive definition of requests the participants may put forth has been avoided.

Although EC integration policies will more directly affect the work of other negotiating groups, some issues may arise within the context of the nontariff measures negotiations. The group is responsible for negotiations on quantitative restrictions and negotiations regarding certain EC restrictions. However, the position of many delegations is that new or GATT-inconsistent quantitative restrictions should be discussed in the Surveillance Body standstill and rollback exercise. Indeed, the EC has submitted an offer to eliminate some of the quantitative restrictions under rollback procedures. EC trading partners will be able to notify as standstill violations any national quantitative restrictions that the EC Commission translates to EC-wide measures.

On other nontariff barriers, if the statements of European officials regarding "credit" for liberalization are followed through upon, the EC may want to use the negotiations to gain concessions for new measures that are more

[22] "Uruguay Round Mid-Term Review," *Business America* (Jan. 16, 1988) p. 7.

liberal than preintegration measures. This approach could cause complication for several reasons: (1) The liberalizing effects may not be clear, (2) EC trade partners may be reluctant to grant Uruguay Round concessions for measures that the EC would be implementing in any event because of its own internal progam, and (3) whereas the EC might be requesting concessions on 1992-related actions, its trading partners could not, at the same time, use this forum to gain compensation for 1992 actions that are more restrictive. Were it not for the overlap between integration and the trade round, issues related to both "credit" and compensation would be thrashed out together in negotiations under GATT provisions on customs unions.[23]

Agriculture

Generally, the Uruguay Round negotiations on agriculture are more closely related to the European Common Agricultural Policy (CAP) whose reform is not directly addressed under the current market-integration effort. Nevertheless, one area of overlap is phytosanitary and health standards that affect agricultural trade. The EC is working to set new standards and harmonize existing ones. In the Uruguay Round, discussion of these issues has thus far been sponsored within the framework of the agriculture negotiations.

Work in the agriculture group has resulted in tentative consensus on the resolve to "strengthen article XX so that measures taken to protect human, animal, or plant life or health are based on sound scientific evidence and recognize the principle of equivalency."[24] Some aspects of these issues may also arise in the Uruguay Round negotiating group on MTN agreements and arrangements to the extent that issues related to the reform of the Standards Code are raised. These issues may also arise in the Group on Nontariff Measures if GATT members table request/offer proposals that include agriculture-related measures.

MTN Agreements and Arrangements

This group's mandate is to work on improving the operation of the codes negotiated during the Tokyo Round.[25] During the past 2 years the group has raised issues regarding the Standards Code. Some negotiators have proposed improving the code's provisions for transparency in the publication and implementation of national standards and certification rules. On the Government Procurement Code, proposals have been circulated regarding changes in accession procedures with a view to attracting more GATT members to become signatories.[26] At the midterm review, trade ministers summarized the progress of the group and the existing areas of agreement. The group reported that some texts based on proposals and background information had been drafted and others would be prepared during 1989 to serve as a basis for further negotiations.

Government Procurement Code

Periodic renegotiations of the code's coverage are authorized under the terms of the code itself. However, the current round of code renegotiations is being conducted with Uruguay Round objectives in sight and is, in effect, wrapped into the Uruguay Round negotiations.

The second and current phase of the renegotiations, which began in 1987, aims to expand the code's coverage. This phase consists of two main elements: one on the expansion of the code to the so-called excluded sectors—water, energy, transportation, and telecommunications—and the second on expanding the code to cover services contracts. A meeting in January 1989 resulted in a decision on the negotiating modalities for the final talks leading to code expansion. Several representatives have suggested that a request/offer approach be used, whereas others are inclined to try a more innovative approach. Regardless of the decision on modalities, entity expansion negotiations should commence early next summer with a tentative target for completion in late 1990.[27]

The EC has supported these objectives. A recent EC Commission pronouncement stated—

> Signatories to the Code have agreed to provide mutual nondiscriminatory access to public procurement markets in specified sectors. For the sectors not covered by the GATT Code, the Community is ready to extend the guarantee of equal market access to achieve a balance between advantages and obligations. Discussions are underway in the Uruguay Round to expand the GATT Code to areas that are not now covered.[28]

[23] See the discussions of negotiating compensation under arts. XXIV and XXVIII above in ch. 1 of pt. III of this report.
[24] GATT, *Report by the Chairman of the Negotiating Group on Agriculture* (MTN.GNG/16) as published in "News of the Uruguay Round," Press release No. NUR 23, Dec. 14, 1988.
[25] Some of the codes cover nontariff measures such as antidumping, subsidies, and countervailing duties (CVDs), standards, government procurement, customs valuation, and import licensing. Three other agreements cover sector trade in bovine meat, dairy products, and civil aircraft. The Subsidies Code issues are also being addressed in a Uruguay Round negotiating group on subsidies and countervailing measures and in the agriculture negotiating group.
[26] The EC and the United States are members of the code, but the concern is that few developing countries have signed.
[27] Merin, Mike, Office of Multilateral Affairs, U.S. Department of Commerce, "Government Procurement Code Negotiations Near Critical Phase," *Uruguay Round Insider* (November 1988).
[28] EC Office of Press and Public Affairs, *European Community News* 23/88, Sept. 15, 1988.

Developments related to 1992 in the European Community have major significance for the renegotiations. In general, the EC's actions to date are having a positive effect on attempts to expand the code's coverage. The most significant reason the EC refrained from covering contracts in certain sectors of interest to U.S. exporters during the Tokyo Round was apparently the EC's lack of authority from the member states to negotiate with third parties regarding the "excluded sectors." The 1992 initiative reportedly has turned the EC into an active and constructive participant in the negotiations.[29]

The United States, then, may have an opportunity to secure desired commitments and address concerns arising from various 1992 directives in these negotiations. It is expected that the issue of treatment of non-EC suppliers will be discussed in the context of the renegotiation of the code, particularly the EC's proposed 50-percent value-added rule. U.S. suppliers are very much interested in securing rights to compete for contracts with EC public entities in the water, energy, transport, and telecommunications sectors and in receiving guarantees of fair, nondiscriminatory treatment in EC procurement. The EC may seek increased access for its firms in other signatories' markets in return.

Standards Code[30]

The United States has several key objectives in the renegotiation of the Standards Code being undertaken as part of the Uruguay Round; including improved transparency in the operation of regional standardsmaking bodies; greater openness with respect to procedures for issuing product approval, testing, and inspection; and extension of the code to include process and production methods. Several proposals on the table in the Uruguay Round address these objectives. These proposals are particularly relevant, given the EC's proposed "new approach" to standards development. The primary concern of U.S. industry appears to be the lack of U.S. access to the EC's standards-drafting process (see pt. II, ch. 6 for details).

One of these proposals is a U.S. proposal to improve transparency in regional standards activities. The U.S. proposal is to amend the code to include an additional obligation for central governments ("Parties") to ensure that amendments to international standards made at the regional level do not create unnecessary obstacles to trade. The proposal also includes a draft "code of conduct" to be agreed upon by regional bodies themselves which, among other things, would facilitate the early exchange of information and provide an opportunity for participation on the same basis as firms in member countries. The proposal is an attempt to prevent the creation of new barriers to trade by ensuring that signatories to the code will have opportunities to comment on standards drafted by such bodies at an early stage, and to encourage the regional institutes to respond to all reasonable foreign requests for modifications.

Many Parties to the code belong to a variety of governmental and non-governmental regional standards-development organizations. Frequently, these regional organizations have procedures that prevent nonmembers from fully participating in the regional organizations' development of standards of related activities. If regional bodies allow nonmembers to comment on proposed standards or certification systems, it is often at a point when consensus among the members has been previously achieved, and there is no guarantee that these comments will be seriously considered and taken into account. As a result, U.S. manufacturers reportedly have complained that they suffer several disadvantages relative to members of such bodies:

(1) The opportunity for interested individuals to comment on proposed regional standards or certification systems is severely restricted; there is no assurance that comments provided will be taken into account;

(2) The closed nature of regional organizations provides producers in these countries with a time advantage in adapting to new standards, as they have advance knowledge of standards under development;

(3) Even if regional organizations base their work on international standards, the resulting standards are biased towards technologies used by firms in their member countries; and,

(4) Participation in regional activities can undermine the international standards-setting process through (a) 'bloc voting' by regional members in international meetings, or (b) the circumvention of intentional standardization in the development of regional standards.

The United States has expressed its concern at code committee meetings and in bilateral discussions that the lack of transparency in regional standards activity disadvantages nonmember countries and is contrary to the code. The United States maintains that it is inconsistent with the spirit of the code for a Party (or Parties) to engage in the development of regional standards that other Parties are not provided an opportunity to comment upon.

The United States maintains that increased transparency by regional standards organizations would improve the functioning of the Standards Code and further U.S. objectives. The United

[29] Merin, Mike, Office of Multilateral Affairs, U.S. Department of Commerce, "Government Procurement Code Negotiations Near Critical Phase," *Uruguay Round Insider* (November 1988).
[30] This section is based primarily by information supplied by the Office of the United States Trade Representative.

States has therefore proposed that (1) third countries (nonmembers of the regional body or system that are signatories to the Standards Code) having a legitimate interest in the activities of regional standards bodies or certification systems should have timely access to information on the development of standards if these standards are likely to affect their trade interests; and, (2) the nondiscriminatory treatment relating to members and third parties should be ensured.

Several Uruguay Round proposals deal with the issue of testing and certification. The United States has tabled a proposal regarding product-approval procedures. The proposal calls for the expansion of code discipline to cover procedures for issuing product approval granted by central-government bodies. The Nordic delegation has put forth several proposals to (1) further define existing code obligations to ensure that Parties' legislation, regulations, and procedures permit the acceptance of foreign-generated test data and (2) bring inspection procedures, not currently covered by the code, under full coverage. Japan has also put forward proposals on transparency in certification systems.

Expanding GATT Coverage

It is in new areas that the impact of EC 1992 initiatives and the relationship between these and the Uruguay Round is most unpredictable. Since both sets of negotiations are developing policies in uncharted territory, positions and principles on the new issues are in flux. In most new issue areas, the United States is in the forefront seeking international agreement. The EC's similar commitment is illustrated in remarks by EC External Relations Commissioner de Clercq. "We must broaden GATT's scope," he recently stated, "The importance of the new subjects is widely recognized: A GATT not dealing with these issues would be a powerless anachronism."[31]

GATT trade ministers agreed in Montreal that negotiations on a framework of rules for trade in services should continue. Ministers approved a text, prepared by the Group on Negotiations on Services, stating that the principles of transparency, national treatment, most-favored-nation treatment, and nondiscrimination are relevant to these negotiations[32] The issue of whether any services sectors would be excluded from a services framework or would require special considerations was left open.[33]

U.S. officials recognize the degree to which ambitious EC initiatives on services and the Uruguay Round efforts will coincide. One Commerce Department official recently wrote—

The internal market program is having a spill-over effect in other fora. The single most important aspect is the Community's approach, in a multilateral context, to the Uruguay Round's Group of Negotiations on Services. . . Given the EC's prominence in world services trade, positions developed in the internal market program—and extended to GNS negotiations—will have an important effect on the multilateral framework.[34]

The EC has strongly supported the push to extend GATT coverage to services trade. One statement of the EC Commission asserts that "the EC attaches great importance to the work of the relevant negotiating group in the Uruguay Round, which it hopes will lead to the opening of markets in this sector." This enthusiasm is tempered by certain caveats, however. The statement claims that the EC is "perfectly willing" to open up its services sector "provided its major trading partners are prepared to do likewise." It also cautions that "the EC cannot deprive itself of negotiating leverage by making unilateral concessions in this sphere."[35] Thus, while the EC agreed at Montreal to the need to apply national treatment to trade in services, its policy statements on EC integration do not unequivocally support this stance. Moreover, EC Commissioner for External Affairs Willy de Clercq has maintained that the internal move toward services liberalization will "be extended beyond the borders of the Community, using the principle of reciprocity."[36]

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[31] De Clercq, Willy, EC Commissioner for External Relations and Trade Policy, "The European Community's Place in a Multilateral World," Speech to the World Economic Forum, Geneva, Nov. 14, 1988.

[32] Trade Negotiations Committee, Meeting at the Ministerial Level, Montreal, December 1988, MTN.TNC/7(MIN) Dec. 9, 1988, Pt. II, Negotiations on Trade in Services, as published in GATT Press Release No. NUR 23, Dec. 14, 1988. The text defined national treatment stating, "It is understood that national treatment means that the services exports and/or

[32]—*Continued*
exporters of any signatory are accorded in the market of any other signatory, in respect of all laws, regulations and administrative practices, treatment 'no less favorable' than that accorded domestic services or services providers in the same market."

[33] The text noted that "these concepts, principles and rules will have to be examined with regard to their applicability and the implications of their application to individual sectors and the types of transaction to be covered by the multilateral framework." Trade Negotiations Committee, Meeting at Ministerial Level, Montreal, December 1988, MTN.TNC/7(MIN) Dec. 9, 1988, Pt. II, Negotiations on Trade in Services, as published in GATT Press Release No. NUR 23, Dec. 14, 1988.

[34] Free, Brant W., "The EC Single Internal Market: Implication for U.S. Service Industries," *Business America* (Aug. 1, 1988), p. 11.

[35] "Europe without Borders: Answers to some Questions," *Europe* (October 1988).

[36] *International Trade Reporter* 5 (Aug. 10, 1988), p. 1134.

The move to extend EC Commission authority, formerly held by member states, to cover services regulation will apply to a broad range of sectors. The EC Commission will have competence in such areas as telecommunications, insurance, securities, banking, transport, broadcasting, advertising and a variety of professional services. EC efforts at formulating directives on banking and financial services are more advanced than in other areas of services. Proposed banking-sector directives already contain provisions calling for reciprocity from non-EC states.[37] The apprehension is that this EC approach may indicate a precedent that the EC will apply in other service sectors and that will influence its positions in Uruguay Round negotiations on services.

One of the principal U.S. concerns is that EC proposals for reciprocity in the services sector will frustrate aims being sought in the Uruguay Round. Former Deputy Treasury Secretary McPherson has asserted that, "reciprocity that seeks identical commercial privileges in countries with different regulatory regimes will almost inevitably result in discrimination,[38] which is contrary to the rules and spirit of the GATT. State Department briefs indicate that the United States "would argue strongly that nations have differing regulatory views on how best to serve and protect the public, and U.S. firms should not be excluded from other markets because of such differences[39] and that national treatment, rather than strict reciprocity, should be the standard for access. One observer noted that if the EC adopts "a narrow form of reciprocity as the basis for granting multilateral or bilateral access to markets, the Uruguay Round may not produce the results . . . that both appear to desire.[40]

[37] For further information see the section of this report on financial services, particularly the Second Banking Directive.

[38] McPherson, Peter M., then-Deputy Secretary of the Treasury, "The European Community's Internal Market Program: An American Perspective," Remarks before the Institute for International Economics, Aug. 4, 1988.
[39] U.S. Department of State, *Western Europe Regional Brief*, November 1988.
[40] Harrison, Glennon J., *The European Community's 1992 Plan: An Overview of the Proposed 'Single Market,'* Congressional Research Service, Sept. 21, 1988, p. 27.

CHAPTER 16
EC INTEGRATION AND OTHER EC COMMITMENTS

CONTENTS

Chapter 16

EC Integration and Other EC Commitments

Introduction and Scope

The White Paper proposals to establish a single European Community market by 1992 include legislative initiatives affecting a wide variety of sectors and activities. Many of these sectors and activities have been addressed in the international arena by negotiations and agreements, whether formal or informal, multilateral or bilateral, intergovernmental or private, binding or voluntary. This chapter will consider agreements, other than those related to the General Agreement on Tariffs and Trade (GATT),[1] to which the United States and member states of the EC are party, and whose demands upon member states bear reexamination and comparison to aspects of the 1992 program.[2] Specifically, the discussion will analyze the Code of Liberalization of Capital Movements (the Capital Movements Code) of the Organization for Economic Cooperation and Development (OECD) and the friendship, commerce, and navigation treaties (FCNs) between the United States and EC member states. This chapter will consider how the concept of reciprocity,[3] as presented in the EC's proposed Second Banking Directive and elsewhere,[4] may conflict with obligations under these agreements. Other commitments may merit similar analysis as additional directives are approved and implemented, but the relationship between reciprocity and EC member states' responsibilities under this OECD Code and the FCNs is judged by U.S. Government officials to be by far the most relevant to this discussion at the present time.[5]

[1] The GATT and Uruguay Round are addressed in chs. 14 and 15, respectively.

[2] "The analysis should include consideration of the relationship and differences between policies and principles, such as sectoral reciprocity, proposed for the EC single market and current EC or member state obligations and commitments under bilateral or multilateral agreements and codes to which the United States is a party." Letter to the Honorable Anne Brunsdale, dated Oct. 11, 1988, from Lloyd Bentsen, Chairman, U.S. Senate Committee on Finance and Dan Rostenkowski, Chairman, U.S. House of Representatives Committee on Ways and Means.

[3] Reciprocity is the subject of a separate chapter and will not be exhaustively explored in this chapter. See ch. 5 for that discussion. For the purpose of this chapter, reciprocity is defined generally as similar terms of competition between trading partners.

[4] Substantially similar reciprocity provisions appear in the proposed Second Banking Directive, Capital Movements Directive, and Second Life Insurance Directives. Other aspects of these directives are discussed in ch. 13, Financial Sector.

[5] This chapter was prepared with the assistance of the U.S. Department of State. Other commitments may be addressed in follow up studies of the EC single market program by the USITC.

The OECD[6]

The OECD was founded in 1961, replacing the Organization for European Economic Cooperation, which had been instituted in 1948 through the Marshall Plan. The organization provides a forum for the government representatives of industrialized nations to discuss social and economic cooperation. The United States and the 12 member states of the EC are members. The Commission of the European Communities (EC Commission) participates in the work of the organization with a special status formalized in a protocol signed at the same time as the Convention of the OECD. "Executive" authority lies in the Ministerial Council, comprising member-state officials.

Article 5(a) of the OECD Convention states that Council decisions are binding on member states "except as otherwise provided . . . ." Article 6(3) frees a member state from the obligations of such decisions "until it has complied with the requirements of its own constitutional procedures"; however, such compliance is not obligatory. A state that adopts domestic constitutional measures that conflict with existing OECD Council decisions is not similarly excused from its obligations. Other nations have questioned to what extent OECD Council decisions are binding; however, the U.S. Government has generally supported the organization's assertion that such decisions are binding on member states. The Capital Movements Code is an example of such a Council decision.

OECD officials report that the organization considers and discusses actions taken by contracting parties that may affect obligations under the codes and other agreements. For example, aspects and provisions of the Canada-United States Free-Trade Agreement and the U.S. 1988 Trade Act (the Omnibus Trade and Competitiveness Act of 1988) were debated in committee and ministerial meetings. Likewise, the EC single-market program is considered. These discussions may constitute either official or informal exchanges of views.

The Capital Movements Code

The Capital Movements Code, adopted in 1961, calls upon contracting parties "to progressively abolish. . . restrictions on movements of capital . . . ."[7] The Committee on Capital Movements and Invisible Transactions is charged with carrying out the operations specified in the code.

There are several ways for a party to excuse itself from the requirements of this code. First of

[6] This discussion draws upon information obtained in USITC staff meetings with officials of the OECD and the U.S. Mission to the OECD.

[7] Art. 1 of the Capital Movements Code.

all, according to article 2(b), a state may lodge a reservation when changing circumstances affect any number of a broad range of activities. Such reservations have been lodged primarily with regard to foreign investment in the transportation and financial-service sectors. Having lodged a reservation, the state is subsequently excused from becoming bound to honor the specified obligation. Procedures are specified for the reporting and monitoring of reservations in article 12.

Article 3 also allows a state to take action inconsistent with the code to maintain "public order," protect the health and safety of its citizens, or honor "its obligations relating to international peace . . . ." According to article 10, members of a customs union are permitted to apply more liberal measures to one another without extending such benefits to other nations. This final provision does not, however, permit a customs union to raise barriers to capital movements with third countries.

Further, article 7 provides that states may derogate from obligations if economic circumstances warrant such action. One example of such economic circumstances is a balance-of-payments problem. Procedures are specified for the reporting and monitoring of derogations in article 13. Derogations are subject to disapproval by the organization, in which case consultations are held with the country involved.

Article 8 grants to contracting parties a general right to benefit from all actions taken by other states to comply with the code even if the beneficiary does not accord similarly liberal treatment. Article 9 further states that member states "shall not discriminate as between other Members in authorizing . . . . transactions and transfers . . . . which are subject to any degree of liberalization." These articles clearly define the concept of liberalization among member countries as unconditional or nonreciprocal; however, the code itself does not specifically deny states the option of considering reciprocity in the implementation of their obligations under the code.

Annex E to the Capital Movements Code

Annex E to the code, "Decision of the Council Regarding Measures and Practices Concerning Reciprocity and/or Involving Discrimination among Investors in Various OECD Member Countries in the Area of Inward Direct Investment and Establishment," was adopted in 1986. The annex reaffirms that liberalization should be pursued regardless of actions or measures taken by other member countries and maintains that "measures and practices concerning reciprocity" should be subject to the procedures outlined for reservations. The annex requires that member states notify the organization of reciprocal/discriminatory measures and practices and provides that such measures and practices should be progressively abolished. Thus, the annex recognizes that reciprocity provisions are permissible to the same extent that reservations to the obligations of the code are permissible.

Reciprocity provisions reported by EC member states are the establishment of nonresident investors in banking and/or financial services in general (France, Greece, Italy, the Netherlands, Spain, the United Kingdom, and West Germany) and in selected other sectors (France, Greece, Italy); the establishment of non-EC insurance companies (Belgium, Denmark, France, Greece, Italy, Luxembourg, Portugal, and Spain); and takeovers by non-EC investors (the United Kingdom). These activities are generally "subject to" reciprocity requirements in the specified countries.

In March 1988, the EC Commission published the text of the proposed Second Banking Directive.[8] Article 7 of this proposed directive provides that "requests for authorization of a subsidiary," and information regarding "the acquisition of a participation in a credit institution such that the latter would become its subsidiary," by a firm "whose parent undertaking is governed by the laws of a third country" should be reported to the EC Commission. Authorization of either activity would be suspended while the EC Commission examined "whether all credit institutions of the Community enjoy reciprocal treatment, in particular regarding the establishment of subsidiaries or the acquisition of participations in credit institutions in the third country in question." Suspension of the authorization could be suspended if the EC Commission judged that reciprocity did not exist.[9]

OECD Analysis of the Second Banking Directive

As noted above, the OECD examines developments in the member states that may affect their obligations to the organization. To this end, the Secretariat prepared a memorandum, "The Proposed Second Banking Co-ordination Directive for the European Communities: Issues for Consideration," on the proposed directive. The memorandum concluded that, "if the proposed reciprocity requirements were put into effect by any OECD Member country, that Member could be in breach of its Code obligations" unless either the provisions relating to customs unions or those specified in annex E were applicable. Specifically, "[f]ailure to grant

[8] See ch. 5, on financial services, for further discussion of this directive.
[9] See ch. 13, on reciprocity, for further discussion of this article.

an authorization necessary to the establishment of a non-resident banking operation would be inconsistent with the obligation under Article 2 (a) with respect to the inward direct investment item of the Code (item I/A), unless a reservation were lodged to that item."

With regard to the special circumstances of a customs union, the Secretariat judged that the reciprocity provisions did not constitute the "other measures of liberalization" specified in the code as not requiring application to third countries. Further, "[i]f the Code were to authorize special systems to develop internally by erecting new barriers to operations with countries outside the system, it would open a major breach in the principle of progressive liberalization within the OECD area."

The memorandum then asserts that the provisions of annex E to the Code do not address reciprocity as envisioned in the Second Banking Directive. "Reciprocity" as addressed in the annex "is regarded as a bilateral phenomenon," whereas "reciprocity" as proposed in the directive "could result in obstacles to establishment being placed in the way of enterprises from non-EC countries even if on a bilateral basis the EC member country concerned was satisfied that reciprocity had been achieved."

Five EC member states have reported domestic reciprocity provisions relating to the establishment of foreign banks. Having reported such existing provisions, these countries could implement the proposed EC reciprocity provisions without being in violation of their OECD obligations. However, other EC states have reported no such existing requirements. Thus, according to the Secretariat, "it would appear that the implementation of the proposed EC reciprocity requirement would be incompatible with their obligations under the Capital Movements Code."

Friendship, Commerce, and Navigation Treaties[10]

The United States has negotiated treaties identifying the commercial and related rights of each party (FCNs) with all member states of the EC with the exception of Portugal. The two oldest treaties, with the United Kingdom (1815) and Spain (1902), differ significantly from the post-World War II treaties in that the former are primarily concerned with the rights of individual citizens, whereas the modern treaties address the rights of firms. The modern treaties have certain common characteristics, yet each incorporates unique features. This discussion will consider general themes and provisions of the treaties as relevant to aspects of the 1992 single-market program; however, significant variations on these themes will be noted as well.

National Treatment and Right of Establishment

A similar guarantee of national treatment is incorporated into article VII of FCNs with Belgium, France, Luxembourg, the Netherlands, and the Federal Republic of Germany (West Germany). The West German agreement's text reads—

> 1. Nationals and companies of either Party shall be accorded, within the territories of the other Party, national treatment with respect to engaging in all types of commercial, industrial, financial and other activity for gain, whether in a dependent or an independent capacity, and whether directly or by an agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories: (a) to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business; (b) to organize companies under the general company laws of such other Party, and to acquire majority interests in companies of such other Party; and (c) to control and manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises controlled by nationals or companies of such other Party.

FCNs with Denmark, Greece, Ireland, and Italy offer somewhat different commercial rights. For example, Denmark will give "favorable consideration" to requests to establish banking operations and grants national treatment to a wide range of activities, including financial services. The Greek and Irish treaties assure national treatment in both the establishment and conduct of specified commercial pursuits. Italy provides these guarantees in more general terms.

The "standard" article VII (2) of the Belgian, Dutch, French, Luxembourg, and West German treaties provides for certain common exceptions to national treatment:

> 2. Each Party reserves the right to limit the extent to which aliens may establish, acquire interests in, or carry on enterprises engaged within its territories in communications, air or water transport, banking involving depository or fiduciary functions, or the exploitation of

[10] Not all treaties conveying commercial and related rights are entitled as a treaty of "friendship, commerce, and navigation"; however, for the purposes of this analysis this term is used in a general application.

land or other natural resources. However, new limitations imposed by either Party upon the extent to which aliens are accorded national treatment, with respect to carrying on such activities within its territories, shall not be applied as against enterprises which are engaged in such activities therein at the time such new limitations are adopted and which are owned or controlled by nationals and companies of the other Party. . . .

Established firms, therefore, are protected from further restrictions based on national origin. The Danish treaty allows the application of special requirements to foreign-based insurance providers to ensure accountability. FCNs with Greece, Ireland, and Italy incorporate additional reservations from national treatment for certain professional and financial activities.

Most-Favored-Nation Status

Article VII (4) of the Dutch and West German FCNs guarantees at least most-favored-nation status for U.S. investors:

Nationals and companies of either Party, as well as enterprises controlled by such nationals or companies, shall in any event be accorded most-favored-nation treatment with reference to the matters treated in the present Article.

The Danish, Greek, and Irish treaties offer similar guarantees.

Exceptions for Customs Unions

The Dutch, Greek, Irish, Italian, and West German treaties have provisions allowing the Parties to make exceptions to terms of the agreement because of membership in a customs union.

Article 234 of the Treaty of Rome

The Treaty of Rome addresses the other international commitments of the member states in Article 234, which reads—

The rights and obligations arising from agreements concluded before the entry into force of this Treaty between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty.

To the extent that such agreements are not compatible with this Treaty, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established. Member States shall, where necessary, assist each other to this end and shall, where appropriate, adopt a common attitude.

In applying the agreements referred to in the first paragraph, Member States shall take into account the fact that the advantages accorded under this Treaty by each Member State form an integral part of the establishment of the Community and are thereby inseparably linked with the creation of common institutions, the conferring of powers upon them and the granting of the same advantages by all the other Member States.

Thus, the Treaty of Rome calls upon member states to resolve inconsistencies between EC and bilateral commitments and stresses unity of action and purpose among its members. All of the U.S.-EC member-state FCNs have mechanisms allowing either party to terminate the agreement, and the Dutch FCN has a specific "escape clause" that cites EC obligations.

APPENDIXES

APPENDIX A
REQUEST LETTER

RECEIVED
88 OCT 13 P1:07
OFFICE OF THE SECRETARY
DOCKET/USITC

Congress of the United States

Washington, DC 20515

October 11, 1988

DOCKET
DOCKET NUMBER
1469
Office of the Secretary
U.S. International Trade Commission

OFFICE OF THE CHAIRMAN
88 OCT 13 P12:16
RECEIVED

The Honorable Anne Brunsdale
Acting Chairman
U.S. International Trade Commission
500 E Street, S.W.
Washington, D.C. 20436

Dear Madam Chairman:

A development of major international importance and of increasing interest to the House Committee on Ways and Means and the Senate Committee on Finance is the economic integration of the European Community (EC) into a single market, scheduled to be in place by the end of 1992. The form and content of the policies, laws, and directives removing economic barriers and restrictions and harmonizing practices among the EC member states may have a significant impact on U.S. trade and investment and on U.S. business activities within Europe, overall and in particular sectors. The process of creating a single market may also affect progress and results in the ongoing Uruguay Round of GATT multilateral trade negotiations.

In order to provide a basic understanding of these developments, their significance, and possible effects, on behalf of the Committees we are requesting that the U.S. International Trade Commission conduct an investigation under section 332(g) of the Tariff Act of 1930 to provide objective factual information on the EC single market and a comprehensive analysis of its potential economic consequences for the United States.

The Commission's report should focus on the following aspects of the proposed single market, in particular:

1. The anticipated changes in laws, regulations, policies, and practices of the EC and individual member states that may affect U.S. exports to the EC and U.S. investment and business operating conditions in Europe, such as changes in customs requirements and procedures, government procurement practices, investment policies, services directives, and tax systems. The analysis should include consideration of the relationship and differences between policies and principles, such as sectoral reciprocity, proposed for the EC single market and current EC or

member state obligations and commitments under bilateral or multilateral agreements and codes to which the United States is a party.

2. The likely impact of such changes on major sectors of U.S. exports to the EC, such as agricultural trade and telecommunications.

3. An assessment of whether particular elements of the single market may be trade liberalizing or trade discriminatory with respect to third countries, particularly the United States.

4. The relationship and possible impact of the single market exercise on the Uruguay Round of GATT multilateral trade negotiations.

We understand that the European Community intends to accomplish its goal of a unified market through the adoption of some 286 Internal Market Directives, which currently are in various stages of preparation, and that a text is not yet available to the public for approximately one-fourth of the proposed directives.

Given the great diversity of topics which these directives address, and the fact that the remaining directives will become available on a piecemeal basis, the Commission should provide the requested information and analysis to the extent feasible in an initial report by July 15, 1989, with follow-up reports as necessary to complete the investigation as soon as possible thereafter. Shortly after receipt of this letter, Commission staff should consult with staffs of our Committees to agree on the topics to be covered in the initial report.

In preparing these reports, the Commission should seek views and input from the private sector. The Commission should also cooperate with and utilize existing information available from U.S. Government agencies to the fullest extent possible.

Sincerely yours,

Lloyd Bentsen
Chairman
Committee on Finance

Dan Rostenkowski
Chairman
Committee on Ways and Means

APPENDIX B
FEDERAL REGISTER NOTICE

LTFV imports of generic cephalexin capsules from Canada. Accordingly, effective October 27, 1988, the Commission instituted preliminary antidumping investigation No. 731-TA-423 (Preliminary).

Notice of the institution of the Commission's investigation and of a public conference to be held in connection therewith was given by posting copies of the notice in the Office of the Secretary, U.S. International Trade Commission, Washington, DC, and by publishing the notice in the Federal Register of November 4, 1988 (53 FR 44676). The conference was held in Washington, DC, on November 16, 1988, and all persons who requested the opportunity were permitted to appear in person or by counsel.

The Commission transmitted its determination in this investigation to the Secretary of Commerce on December 12, 1988. The views of the Commission are contained in USITC Publication 2143 (December 1988), entitled "Generic Cephalexin Capsules from Canada: Determination of the Commission in Investigation No. 731-TA-423 (Preliminary) Under the Tariff Act of 1930, Together With the Information Obtained in the Investigation."

By order of the Commission.

Issued: December 14, 1988.

Kenneth R. Mason,

Secretary.

[FR Doc. 88-29293 Filed 12-20-88; 8:45 am]

BILLING CODE 7020-02-M

[332-267]

The Effects of Greater Economic Integration Within the European Community on the United States

AGENCY: United States International Trade Commission.

ACTION: Institution of investigation and scheduling of hearing.

SUMMARY: Following receipt on October 13, 1988 of a request from the Committee on Ways and Means of the United States House of Representatives and the Committee on Finance of the United States Senate, the Commission instituted investigation No. 332-267 under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)) to provide objective factual information on the EC single market and a comprehensive analysis of its potential economic consequences for the United States. The Committee requested that the Commission investigation focus in particular on the following:

1. The anticipated changes in laws, regulations, policies, and practices of the EC and individual member states that may affect U.S. exports to the EC and U.S. investment and business operating conditions in Europe, such as changes in customs requirements and procedures, government procurement practices, investment policies, service directives, and tax systems. The Committees requested that the analysis include consideration of the relationship and differences between policies and principles, such as sectoral reciprocity, proposed for the EC single market and current EC or member state obligations and commitments under bilateral or multilateral agreements and codes to which the United States is a party.

2. The likely impact of such changes on major sectors of U.S. exports to the EC, such as agricultural trade and telecommunications.

3. An assessment of whether particular elements of the single market may be trade liberalizing or trade discriminatory with respect to third countries, particularly the United States.

4. The relationship and possible impact of the single market exercise on the Uruguay Round of GATT multilateral trade negotiations.

The Committees requested that the Commission provide the requested information and analysis to the extent feasible in an initial report by July 15, 1989, with follow up reports as necessary.

EFFECTIVE DATE: December 13, 1988.

FOR FURTHER INFORMATION CONTACT: For information on other than the legal aspects of the investigation contact either Mr. John J. Gersic at 202-252-1342, or Mr. David R. Konkel at 202-252-1451.

For information on legal aspects of the investigation contact Mr. William W. Gearhart at 202-252-1091.

PUBLIC HEARING: A public hearing in connection with the investigation will be held in the Commission Hearing Room, 500 E Street SW., Washington, DC, beginning at 9:30 a.m. on April 11, 1989, and continuing as required on April 12, 1989. All persons shall have the right to appear by counsel or in person, to present information, and to be heard. Persons wishing to appear at the public hearing should file requests to appear and should file prehearing briefs (original and 14 copies) with the Secretary, United States International Trade Commission, 500 E Street SW., Washington, DC 20436, not later than 5:00 p.m., March 28, 1989. Post-hearing briefs may be submitted no later than April 26, 1989.

WRITTEN SUBMISSIONS: In lieu of or in addition to appearances at the public hearing, interested persons are invited to submit written statements concerning the investigation. Written statements should be received by the close of business on April 26, 1989. Commercial or financial information which a submitter desires the Commission to treat as confidential must be submitted on separate sheets of paper, each clearly marked "Confidential Business Information" at the top. All submissions requesting confidential treatment must conform with the requirements of § 201.6 of the Commission's *Rules of Practice and Procedure* (19 CFR 201.6). All written submissions, except for confidential business information, will be available for inspection by interested persons. All submissions should be addressed to the Secretary at the Commission's office in Washington, DC.

Hearing impaired persons are advised that information on this matter can be obtained by contacting the Commission's TDD terminal on (202)-252-1810.

By order of the Commission.

Issued: December 15, 1988.

Kenneth R. Mason,

Secretary.

[FR Doc. 88-29291 Filed 12-20-88; 8:45 am]

BILLING CODE 7020-02-M

[Investigation No. 337-TA-279]

Certain Plastic Light Duty Screw Anchors; Commission Determination Not To Review Initial Determination and Schedule for Filing of Written Submissions on Remedy, the Public Interest, and Bonding

AGENCY: U.S. International Trade Commission.

ACTION: Notice.

SUMMARY: Notice is hereby given that the U.S. International Trade Commission has determined not to review an initial determination (ID) finding a violation of section 337 of the Tariff Act of 1930 in the above-captioned investigation. The parties to the investigation, interested government agencies, and interested members of the public are requested to file written submissions on the issues of remedy, the public interest, and bonding.

FOR FURTHER INFORMATION CONTACT: Mitchell W. Dale, Esq., Office of the General Counsel, U.S. International Trade Commission, telephone 202-252-1087.

SUPPLEMENTARY INFORMATION: The authority for the Commission's disposition of this matter is contained in section 337 of the Tariff Act of 1930 (19 U.S.C. 1337) and in §§ 210.53(h) and 210.58(a) of the Commission's Interim

APPENDIX C
LIST OF EC 92 INITIATIVES ADDRESSED IN THIS INVESTIGATION

APPENDIX C: LIST OF EC 92 INITIATIVES ADDRESSED IN THIS INVESTIGATION

(Dir=Directive, Rec=Recommendation, Dec=Decision, Reg=Regulation)

Government procurement

# Enacted	*Description*	*Relevant U.S. Sector/Industry*
88/295-Dir	Revises procedures on the award of public-supply contracts	Potentially all

# Proposed	*Description*	*Relevant U.S. Sector/Industry*
(86)679-Dir	Coordinates procedures for the award of public-works contracts	Potentially all
(88)376-Dir	Regime for procurement in water, energy, transport, and telecommunications sectors	Energy, water, transport, telecom.
(88)377-Dir	Procurement procedures of entities providing water, energy, and transport services	Energy, water, transport
(88)378-Dir	Procurement procedures of entities in the telecommunications sector	Telecom.
(88)733-Dir	Coordinates laws and regulations for awarding public-supply and public-work contracts	Potentially all

Financial sector

# Enacted	*Description*	*Relevant U.S. Sector/Industry*
85/583-Dir	Liberalization of movement of units of collective investment undertakings in transferable securities	Mutual funds
85/611-Dir	Harmonizes laws relating to undertakings for collective investment in transferable securities	Mutual funds
86/566-Dir	Liberalization of capital movements	Potentially all
86/635-Dir	Accounting practices for financial institutions	Banking
87/62-Rec	Sets recommended guidelines for monitoring large exposures of credit institutions	Banking
87/63-Rec	Sets recommended guidelines for the introduction of deposit-guarantee schemes for financial institutions	Banking
87/343-Dir	Regulates investment in direct insurance other than life insurance	Insurance
87/344-Dir	Coordination of laws, regulations, and administrative provisions relating to legal-expenses insurance	Insurance
87/345-Dir	Requirements for the admission of securities onto the official stock-exchange listing	Securities
87/598-Rec	Recommends compliance with European Code of Conduct Relating to Electronic Payment	Banking
88/220-Dir	Revises laws, regulations, and administrative provisions relating to undertakings for collective investments in transferable securities	Mutual funds
88/357-Dir	Lays down provisions to facilitate the freedom to provide direct insurance services other than life insurance	Insurance
88/361-Dir	Implementation of article 67 of the treaty regarding freedom of capital flows	Potentially all
88/524-Dec	Plan of action for the development of an information-services market	Information services
88/627-Dir	Public-disclosure requirements for changes in major stock holdings of publicly held companies	Securities
89/117-Dir	Requirements for annual reporting by branches of credit and financial institutions outside the member state of the head office	Banking
89/298-Dir	Requirements for public offer prospectus	Securities
89/299-Dir	Reserve requirements for credit institutions	Banking

Financial sector—*Continued*

# Proposed	Description	Relevant U.S. Sector/Industry
(80)854-Dir	Regulation of laws and administrative provisions relating to insurance contracts	Insurance
(86)764-Dir	Accounting requirements for insurance firms	Insurance
(86)768-Dir	Bankruptcy regulations for insurance firms	Insurance
(87)255-Dir	Freedom of establishment and the free supply of services in the field of mortgage credit	Banking
(87)715-Dir	Regulation and authorization of credit institutions in member states	Banking
(88)4-Dir	Reorganization and the winding-up of credit institutions and deposit-guarantee schemes	Banking
(88)194-Dir	Solvency ratios for credit institutions	Banking
(88)549-Dir	Coordinates regulations on insider trading	Securities
(88)729-Dir	Second directive laying down provisions to facilitate the exercise of freedom to provide life insurance services	Insurance
(88)778-Dir	Investment services	Securities

Standards

# Enacted	Description	Relevant U.S. Sector/Industry
85/173-Dir	Extends deadline for prohibition of organismsharmful to plants	Agriculture
85/320-Dir	Regulates EC trade in live pigs from areas affected by swine fever	Swine
85/321-Dir	Regulates trade in pork products from areas affected by swine fever	Swine
85/322-Dir	Regulates trade in fresh pork from areas affected by swine fever	Swine
85/323-Dir	Health inspections of meat-production plants	Meat
85/324-Dir	Health inspection of poultry-production plants	Poultry
85/325-Dir	Medical certification of persons employed in the handling of fresh meat	Meat
85/326-Dir	Medical certification of persons employed in handling fresh poultry meat	Poultry
85/327-Dir	Medical certification of persons employed in the handling of fresh meat and meat products	Meat
85/358-Dir	Uniform testing procedures for prohibited hormone growth promoters	Meat
85/374-Dir	Liability for defective products	Potentially all
85/397-Dir	Harmonization of regulations regarding production and sale ofheat-treated milk in the EC	Dairy
85/467-Dir	Labeling of materials containing PCBs and PCTs	Agriculture
85/511-Dir	Control of foot-and-mouth disease	Livestock
85/572-Dir	List of substances (liquids) to be used in migration tests on plastic materials intended to come in contact with foodstuffs	Food products
85/573-Dir	Harmonization of regulations regarding coffee and chicory extracts	Coffee
85/585-Dir	Modifications to regulations on preservatives	Food products
85/591-Dir	Harmonization of methods of sampling and analysis of foodstuffs	Food products
85/610-Dir	Harmonization of regulations regarding asbestos	Potentially all
86/94-Dir	Exemptions from regulations regarding the minimum biodegradability of detergents	Detergents
86/102-Dir	Amends the list of approved emulsifiers, etc., for use in foodstuffs	Food products
86/197-Dir	Labeling regarding alcoholic content of beverages	Alcoholic beverages
86/217-Dir	Standardization requirements for tire-pressure gauges	Pressure gauges
86/355-Dir	Prohibition of ethylene oxide as a pesticide	Agriculture
86/362-Dir	Maximum levels for pesticide residues on cereals	Cereals
86/363-Dir	Maximum levels for pesticide residues on edibleanimal products	Food products
86/469-Dir	Sets requirements for the examination of animals andfresh meat for the presence of residues	Meat
86/594-Dir	Labeling household appliances regarding noise emissions	Household appliances
86/649-Dec	Eradication of African swine fever in Portugal and Spain	Swine
86/650-Dec	Eradication of African swine fever in Portugal and Spain	Swine
86/662-Dir	Noise from hydraulic diggers	Hydraulic diggers

Standards—*Continued*

# Enacted	Description	Relevant U.S. Sector/Industry
86/663-Dir	Regarding safety standards for self-propelled industrial trucks	Industrial trucks
86/666-Rec	Protection of hotels against fire	Hotels
87/19-Dir	Approximation of laws concerning the testing of medicines	Pharmaceuticals
87/20-Dir	Approximation of laws concerning the testing of veterinary medicines	Veterinary medicines
87/21-Dir	Approximation of laws concerning medicines	Pharmaceuticals
87/22-Dir	Approximation of regulations concerning high-technology medicines	Pharmaceutical
87/58-Dec	Eradication of brucellosis, tuberculosis, and leucosis in cattle	Cattle
87/64-Dir	Revises standards regarding health and veterinary inspections on importing bovine animals, swine, from third countries	Livestock, meat and fresh meat
87/95-Dec	Standardizes field of information technology and telecommunications	Telecom.
87/153-Dir	Fixes guidelines for assessing additives in animal nutrition	Livestock
87/176-Rec	Sets recommended guidelines for placing proprietary medicinal products on the market	Pharmaceuticals
87/202-Dec	Accelerates plan for eradication of swine fever	Swine
87/230-Dec	Amends previous legislation regarding the duration and financial means for eradicating swine fever	Swine
87/328-Dir	Accepts intra-EC trade of purebred animals of the bovine species for breeding purposes	Cattle
87/357-Dir	Harmonizes laws regarding products that are mislabeled and that thereby endanger health and safety	Potentially all
87/358-Dir	Harmonizes certification procedures for motor vehicles and their trailers	Motor vehicles
87/372-Dir	Regulates frequency bands for pan-European mobile telephones	Mobile telephones
87/402-Dir	Harmonizes laws related to rollover protection structures for agricultural and forestry tractors	Tractors
87/404-Dir	Harmonizes laws related to simple pressure vessels	Pressure vessels
87/405-Dir	Harmonizes laws related to the permissible sound-power level of tower cranes	Tower cranes
87/491-Dir	Revises the standards regarding animal health problems affecting trade in meat products among member states	Meat
87/519-Dir	Establishes common standards for pesticide residues on animal feedingstuffs	Feedingstuffs
88/76-Dir	Measures to be taken against air pollution by gases from the engines of motor vehicles	Motor vehicles
88/77-Dir	Measures to be taken regarding the emission of gaseous pollutants from diesel engines for use in vehicles	Diesel engines
88/180-Dir	Harmonizes laws regarding the permissible sound-power levels of lawnmowers	Lawnmowers
88/181-Dir	Harmonizes laws regarding the permissible sound-power levels of lawnmowers	Lawnmowers
88/182-Dir	Lays down a procedure for providing information on technical standards and regulations	Potentially all
88/183-Dir	Standardizes the definition of fertilizer	Fertilizer
88/194-Dir	Revises laws relating to the braking devices of certain categories of motor vehicles and their trailers	Motor vehicles
88/195-Dir	Revises laws regarding the engine power of motor vehicles	Motor vehicles
88/218-Dir	Regulations on weights, dimensions, and certain other technical characteristics of refrigerated road vehicles	Refrigerated road vehicles
88/288-Dir	Revises laws regarding health problems affecting intra-EC trade in fresh meat	Meat
88/289-Dir	Revises standards for health and veterinary inspections on imports of bovine animals, swine, from third countries	Livestock, meat and fresh meat
88/297-Dir	Revises laws relating to type-approval of wheeled agricultural or forestry tractors	Tractors
88/298-Dir	Fixes the maximum levels for pesticide residues for fruit, vegetables, and cereals	Agriculture
88/314-Dir	Standards for the labeling of prices for nonfood products	Potentially all
88/315-Dir	Standards for the labeling of prices for food products	Food products
88/316-Dir	Standards of volume for prepackaged liquids	Liquid goods
88/320-Dir	Standards for good laboratory practices and their application for the testing of chemical substances	Potentially all
88/321-Dir	Standards for rearview mirrors of motor vehicles	Motor vehicles
88/322-Dec	Equivalence of field inspections carried out in third countries on seed-producing crops	Agriculture
88/366-Dir	Technical specifications for motor vehicles regarding the field of vision for motor-vehicle drivers	Motor vehicles

Standards—*Continued*

# Enacted	Description	Relevant U.S. Sector/Industry
88/378-Dir	Standards for the safety of toys	Toys
88/379-Dir	Classification, packaging, and labeling of dangerous preparations	Potentially all
88/388-Dir	Harmonizes laws relating to flavorings for foodstuffs and to source material for their production	Food products
88/389-Dec	Establishes an inventory of the source material for flavorings	Flavorings
88/407-Dir	Regulates intra-EC trade and imports of deep-frozen semen of animals of the bovine species	Bovine semen
88/436-Dir	Regulates emission of particle pollutants from diesel engines	Diesel engines
88/449-Dir	Regarding standards for testing the roadworthiness for motor vehicles and their trailers	Motor vehicles
88/465-Dir	Standards for driver's seat on wheeled agricultural or forestry tractors	Tractors
88/483-Dir	Concerning additives in feedingstuffs	Feedingstuffs
88/657-Dir	Health problems relating to the importation of ground meat and meat in pieces of less than 100 grams, from third countries	Meat
88/658-Dir	Health requirements for intra-EC trade in meat products	Meat
88/661-Reg	Zootechnical standards applicable to breeding animals of the porcine species	Swine
88/667-Dir	Amends laws relating to cosmetic products	Cosmetics
89/105-Dir	Price transparency of medicinal products for human use and their inclusion in the scope of national	Pharmaceuticals health insurance
89/107-Dir	Standards for food additives	Food products
89/108-Dir	Standards for quick-frozen foodstuffs	Frozen food
89/235-Dir	Permissible sound level and exhaust system of motorcycles	Motorcycles

# Proposed	Description	Relevant U.S. Sector/Industry
(76)427-Dir	Standards for plant-protection products	Agriculture
(76)712-Dir	Standards for tires of motor vehicles	Motor vehicles, tires
(81)504-Dir	Personnel responsible for inspection of meat products	Meat
(81)712-Dir	Authorized preservatives in foodstuffs intended for human consumption	Food products
(82)529-Dir	Health standards for intra-EC trade of live cattle and pigs	Livestock
(82)626-Dir	Approximates laws relating to the labeling and advertising of foodstuffs for sale to the consumer	Food products
(83)378-Dir	Production and trade in medicated feedingstuffs	Feedingstuffs
(83)655-Dir	Fixing the weight of uncastrated male pigs	Swine
(84)288-Dir	Establishes a timetable for the harmonization of health matters in veterinary, plant health, and legislation	Agriculture feedingstuff
(84)726-Dir	Standards for the use of modified starches intended for human consumption	Food products
(85)782-Dir	Certification of seeds	Agriculture
(86)159-Reg	Description and presentation of spiritous beverages	Alcoholic beverages
(86)273-Dir	Approximates laws relating to the measures to be taken against the emission of gaseous pollutants from diesel engines	Diesel engines
(86)564-Dir	Standards for infant formula and followup milk	Infant formula, dairy
(86)613-Dir	Food additives for fruit jams, jellies, marmalades, and chestnut puree	Food products
(86)657-Dir	Intra-EC trade and imports from third countries ofsemen of animals of the bovine and porcine species	Semen
(86)658-Dir	Imports of meat products from third countries	Meat
(86)688-Dir	Definitions and standards for fruit juices and similar products	Fruit juices
(86)701-Dir	Standards relating to the weights and dimensions of motor vehicles	Motor vehicles
(87)194-Dir	Certain standards for agricultural or forestry tractors	Tractors
(87)239-Dir	Standards for materials intended to come in contact with foodstuffs	Food products
(87)241-Dir	Standards for foodstuffs intended for particular nutritional uses	Food products
(87)242-Dir	Standards for the labeling, presentation, and advertising of foodstuffs for sale to the ultimate consumer	Food products
(87)383-Dir	Control of the acquisition and possession of weapons	Weapons
(87)527-Dir	Radio interferences	Broadcasting
(87)564-Dir	Harmonizes laws relating to the safety requirements for machinery	Machinery

Standards—*Continued*

# Proposed	Description	Relevant U.S. Sector/Industry
(87)646-Dir	Amends previous legislation on the marketing of fertilizers to include fluid fertilizers	Fertilizers
(87)697-Dir	Regulations regarding proprietary medicinal products	Pharmaceuticals
(87)720-Dir	Harmonizes laws concerning the maximum tar yield of cigarettes	Cigarettes
(87)728-Dir	Proposed directive on laws, regulations and administrative provisions of the member states relating to construction products	Construction
(88)?-Dir	Resolution on the development of the common market for telecommunication services and equipment up to 1992	Telecom.
(88)7-Dir	Restrictions on the marketing and use of certain dangerous substances and preparations	Potentially all
(88)41-Dir	Harmonizes laws on package travel, including package holidays and package tours	Travel
(88)47-Reg	Harmonization of health standards concerning nematodes in fish and fish products	Fish
(88)88-Dir	General principles for the performance of official inspection of foodstuffs	Food products
(88)154-Dir	Coordination of laws and regulations relating to broadcasting activities	Broadcasting
(88)157-Dir	Harmonizes laws related to personnel protective equipment	Potentially all
(88)160-Dir	Standards for the deliberate release to the environment and contained use of genetically modified organisms	Biogenetics
(88)170-Dir	Establishes protective measures against the introduction into the member states of organisms harmful to plants or plant products	Agriculture
(88)227-Dir	Health standards for extraction solvents used in the production of foodstuffs and food ingredients	Food products
(88)231-Dir	Regulations on the pricing of medical products and their inclusion within the scope of the national health insurance system	Medical products
(88)287-Dir	Certain technical characteristics of certain road vehicles	Road vehicles
(88)322-Dir	Approximates laws on emulsifiers, stabilizers, thickeners, and gelling agents for use in foodstuffs	Food products
(88)383-Reg	Veterinary checks in intra-EC trade; intensifies controls on the application of veterinary rules	Livestock
(88)588-Dec	EC action in the field of Information Technology and Telecommunications applied to health care	Potentially all
(88)646-Dir	Harmonization of health conditions for production and intra-EC trade of egg products	Poultry, eggs
(88)798-Dir	Fixes the maximum levels for pesticide residues for fruit and vegetables	Agriculture
(88)845-Dir	Harmonizes laws concerning labeling of tobacco products	Tobacco
(89)257-Dir	Standards for gaseous emissions from motor vehicles below 1,400 cc	Motor vehicles

Customs

# Enacted	Description	Relevant U.S. Sector/Industry
85/347-Dir	Increases the allowance for duty-free admission of fuel contained in the fuel tanks of buses	Travel, tourism
85/368-Dir	Comparability of vocational training qualifications	Potentially all
85/432-Dir	Access of persons with certain qualifications in the field of pharmacy to employment for certain professional activities	Healthcare
85/433-Dir	Mutual recognition of diplomas and other formal qualifications in the field of pharmacy	Healthcare
85/434-Dir	Establishment of an advisory committee on pharmaceutical training	Healthcare
85/1900-Reg	Introduces EC export and import forms	Potentially all
85/1901-Reg	Use of Single Administrative Document for EC trade with non-EC countries	Potentially all
86/365-Dec	Establishes a program for cooperation between universities and enterprises for training in the field of technology (COMETT)	Potentially all
86/457-Dir	Requirement for specific training in general medical practice	Healthcare
86/653-Dir	Coordination of laws of member states relating to self-employed commercial agents	Potentially all
86/1797-Reg	Abolishing certain postal fees for customs presentation	Mail order
86/3690-Reg	Elimination of customs formalities upon exit from a member country within the framework of the TIR Convention; introduction of common border posts	Potentially all
88/364-Dir	Measures for the protection of workers from certain chemicals and work activities	Potentially all
88/4233-Reg	Introduction of common border posts	Potentially all
89/48-Dir	Mutual recognition of higher education diplomas	Potentially all

Customs—*Continued*

# Proposed	Description	Relevant U.S. Sector/Industry
(85)224-Dir	Easing of border controls on intra-EC borders	Potentially all
(85)292-Dir	Right of residence for nationals of member states in the territory of another member state	Potentially all
(85)467-Reg	Assistance and cooperation to ensure correct application of customs and agricultural laws	Agriculture
(86)383-Dir	Standardizes provisions on the duty-free admission offuel contained in the tanks of commercial motor vehicles	Potentially all
(86)584-Dir	Permanent imports of personal property from a member state	Potentially all
(87)14-Dir	Temporary importation of motor vehicles	Motor vehicles
(87)21-Dir	Regarding exemption from value added tax on the final importation of fuel in commercial motor vehicles	Potentially all
(88)73-Dir	Introduces measures to encourage improvements in the safety and health of workers in the workplace	Potentially all
(88)74-Dir	Concerning the minimum safety and health requirements for the workplace	Potentially all
(88)76-Dir	Sets minimum health and safety requirements for workers' use of personal protective equipment	Potentially all
(89)195-Dir	Safety and health requirements for work with visual display units	Potentially all
(89)213-Dir	Sets minimum health and safety requirements for workers handling heavy loads that present a risk of back injury	Potentially all

Transport

# Enacted	Description	Relevant U.S. Sector/Industry
86/4055-Reg	Maritime transport	Shipping
86/4056-Reg	Maritime transport	Shipping
86/4057-Reg	Maritime transport	Shipping
86/4058-Reg	Maritime transport	Shipping
87/601-Dir	Regulates air fares between member states	Airlines
87/602-Dec	Regulates passenger capacity rates and access to scheduled air-service routes between member states	Airlines
87/1674-Reg	Amends regulations regarding EC transit operations	Trucking
87/3976-Reg	Clarifies the EC Commission's regulatory powers regarding certain categories of agreements in the air-transport sector	Airlines

# Proposed	Description	Relevant U.S. Sector/Industry
(85)90-Reg	Details rules applicable to maritime transport	Shipping
(85)610-Reg	Conditions under which nonresident carriers may transport goods or passengers by inland waterway within a member state	Shipping
(85)611-Reg	Conditions under which nonresident carriers may operate national road haulage services within a member state	Trucking
(87)31-Reg	Conditions under which nonresident carriers may operate national road passenger-transport services within a member state	Passenger carriage
(87)79-Reg	Rules for the international carriage of passengers by coach and bus	Passenger carriage
(87)584-Reg	Fixes the rates for the carriage of goods by road between member states	Trucking
(87)729-Reg	Access to the market for the carriage of goods by road between member states	Trucking
(88)126-Dir	Rules for authorizing scheduled interregional air services between member states	Airlines

Competition policy

# Enacted	Description	Relevant U.S. Sector/Industry
85/2137-Reg	Regulation of European Economic Interest Groups	Potentially all
88/301-Dir	Establishes guidelines for competition in the market for telecommunications terminal equipment	Telecom.

# Proposed	Description	Relevant U.S. Sector/Industry
(73)1234-Reg	Controls concentration within business undertakings	Potentially all
(83)185-Dir	Sets guidelines for the structure of public limited companies and the powers and obligations of their organs	Potentially all
(84)727-Reg	Regulations for cross-border mergers of public limited companies	Potentially all
(86)238-Dir	Alters the scope of previous directives concerning annual and consolidated accounts	Potentially all
(88)101-Dir	Establishes company law concerning single-member private limited companies	Potentially all
(88)153-Dir	Sets disclosure requirements for branches of certain types of companies governed by the laws of another member state	Potentially all
(88)734-Reg	Controls concentration between industries	Potentially all

Tax systems

# Enacted	Description	Relevant U.S. Sector/Industry
85/348-Dir	Increases the exemption from turnover tax and excise duty on imports in intra-EC travel	Potentially all
85/349-Dir	Increases the relief from turnover tax and excise duty on small consignments of noncommercial value	Potentially all
85/362-Dir	Exemption from the value-added tax (VAT) for the temporary importation of goods other than means of transport	Potentially all
86/560-Dir	Refund of VAT to persons not established in the EC	Potentially all
88/245-Dir	Authorizes France to apply a reduced rate of revenue duty on the consumption of "traditional" rum	Rum

# Proposed	Description	Relevant U.S. Sector/Industry
(76)611-Dir	Eliminates double taxation in connection with the adjustment of transfers of profits between associated enterprises	Potentially all
(79)737-Dir	Harmonizes income tax provisions with respect to the freedom of movement for workers within the EC	Potentially all
(79)794-Dir	Sets procedure for VAT and excise duty on the stores of vessels, aircraft, and international trains	Potentially all
(80)69-Dir	Harmonizes taxes, other than turnover taxes, on consumption of manufactured tobacco	Tobacco
(82)870-Dir	Harmonizes laws of the member states relating to turnover taxes for the common VAT scheme--deduction eligibility	Potentially all
(85)150-Dir	Lays down rules on indirect consumption taxes and excise duties on alcoholic drinks	Alcoholic beverages
(85)151-Dir	Harmonizes excise duties on fortified wine and similar products	Alcoholic beverages
(85)319-Dir	Harmonizes laws relating to tax arrangements for carryover of undertakings	Potentially all
(86)444-Dir	Harmonizes laws of the member states relating to turnover taxes for the common VAT scheme for small and medium-sized business	Potentially all

Tax systems—*Continued*

# Proposed	Description	Relevant U.S. Sector/Industry
(86)742-Reg	Regulates fees payable to the EC trademark office	Potentially all
(87)21-Dir	Regarding exemption from VAT on the final importation of fuel in commercial motor vehicles	Potentially all
(87)139-Dir	Abolishes indirect taxes on transactions in securities	Securities
(87)272-Dir	Harmonizes laws of the member states relating to turnover taxes for the common VAT scheme--abolition of certain derogations	Potentially all
(87)315-Dir	Harmonizes laws of the member states relating to turnover taxes for the common VAT scheme--abolition of certain derogations	Potentially all
(87)321-Dir	Approximates common VAT rates	Potentially all
(87)322-Dir	Removes fiscal frontiers	Potentially all
(87)324-Dir	Institutes a process for converging VAT and excise duty rates	Potentially all
(87)325-Dir	Harmonizes taxes on cigarettes	Tobacco
(87)326-Dir	Harmonizes taxes on manufactured tobacco, other than cigarettes	Tobacco
(87)327-Dir	Harmonizes excise taxes on mineral oils	Mineral oil
(87)328-Dir	Harmonizes excise taxes on alcoholic beverages and on alcohol contained in other products	Alcoholic beverages

Residual quantitative restrictions–None

Intellectual property

# Enacted	Description	Relevant U.S. Sector/Industry
87/54-Dir	Legal protection of semiconductor products	Semiconductors
89/104-Dir	Harmonizes laws relating to trademarks	Potentially all

# Proposed	Description	Relevant U.S. Sector/Industry
(84)470-Reg	Regulates EC trademarks	Potentially all
(85)844-Reg	Implements trademark regulations	Potentially all
(86)731-Reg	Sets procedural rules for the Boards of Appeal on the EC trademark	Potentially all
(88)172-Dir	Green Paper on copyright and the challenge of technology	Potentially all
(88)496-Dir	Legal protection of biotechnological inventions	Biotechnology

APPENDIX D
INDEX OF INDUSTRY/COMMODITY ANALYSES CONTAINED IN REPORT CHAPTERS 4 THROUGH 12

Note.—The industries listed in this index are those industries found to be potentially the most significantly affected by each of the various categories of EC 1992 directives. For example, in examining directives related to intellectual property rights, the industries determined to have the potential to be affected the most are audio recordings, biotechnology, computer softwear, publishing, recorded videocassettes, and semiconductors. Other categories of directives (e.g., standards, government procurement, etc.) likewise were found to affect other groups of industries most significantly. This listing is not a comprehensive listing of all U.S. industries.

INDEX OF INDUSTRY/COMMODITY ANALYSES

APPENDIX E
TRADE TABLES

CONTENTS

CONTENTS—*Continued*

CONTENTS—*Continued*

Page

Table E-1

All commodities: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	F.a.s. value (1,000 dollars)				
European Communities:					
Belgium and Luxembourg	5,108,888	4,676,316	5,197,739	5,942,610	7,131,084
Denmark	578,218	683,429	727,013	831,511	877,337
France	5,795,481	5,810,187	6,877,322	7,504,518	9,572,988
Greece	385,524	392,066	321,260	343,517	545,312
Ireland	1,329,486	1,324,872	1,409,114	1,752,008	2,104,344
Italy	4,186,802	4,433,936	4,667,600	5,305,449	6,457,502
Netherlands	7,366,743	7,057,765	7,580,579	7,868,764	9,504,410
Portugal	942,822	648,338	572,282	569,497	718,383
Spain	2,491,332	2,468,438	2,536,657	3,050,673	3,931,387
United Kingdom	11,570,319	10,657,191	10,579,464	13,140,470	17,255,779
West Germany	8,474,194	8,560,208	9,782,804	10,921,061	13,207,099
Total	48,229,809	46,712,746	50,251,834	57,230,077	71,305,625
Canada	49,768,081	51,064,947	53,165,113	57,001,048	65,910,336
Japan	22,692,129	21,602,930	22,890,847	26,903,632	36,041,575
All other	96,620,038	93,580,690	90,247,408	102,724,168	134,755,934
Grand total	217,310,057	212,961,312	216,555,202	243,858,925	308,013,470

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-2

All commodities: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	3,122,420	3,375,010	3,970,234	4,135,233	4,492,625
Denmark	1,416,883	1,656,561	1,757,624	1,777,546	1,665,879
France	7,944,772	9,336,941	9,961,897	10,501,843	11,910,300
Greece	348,344	397,574	391,874	434,294	531,712
Ireland	832,374	893,588	1,000,327	1,097,547	1,362,264
Italy	7,884,115	9,632,277	10,505,016	10,819,220	11,459,798
Netherlands	4,053,074	4,067,686	4,057,041	3,941,770	4,532,008
Portugal	476,471	543,454	550,649	660,352	691,668
Spain	2,369,406	2,503,035	2,670,767	2,792,105	3,145,993
United Kingdom	14,324,480	14,816,391	15,307,926	16,930,902	17,752,304
West Germany	16,949,816	20,330,266	25,300,982	27,053,535	26,491,655
Total	59,722,155	67,552,783	75,474,337	80,144,348	84,036,204
Canada	66,342,454	68,883,572	68,146,979	70,850,625	80,678,621
Japan	56,595,926	68,241,856	81,985,873	84,008,499	89,110,486
All other	140,328,984	138,874,939	143,049,405	167,062,530	183,314,873
Grand total	322,989,519	343,553,150	368,656,594	402,066,002	437,140,185

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-3

SITC divisions providing the largest impact on the U.S. trade balance with the EC, 1988

SITC division	U.S. imports	U.S. exports	Balance
	In millions of dollars		
75	2,229	10,459	8,230
72	6,166	2,823	3,343
79	3,361	6,380	3,019
22	61	2,059	2,057
87	1,789	3,045	1,256
78	11,166	2,077	(9,089)

Source: Official statistics of the U.S. Department of Commerce.

Table E-4

U.S. exports to the EC, by principal categories, 1984-88

In thousands of dollars

SITC rev 2 community	1984	1985	1986	1987	1988
	Value (1,000 dollars)				
75—Office machines and automatic	6,682,855	6,443,464	6,964,288	8,330,389	10,458,914
79—Other transport equipment	2,837,113	3,517,403	4,225,459	5,144,153	6,379,725
77—Electrical machinery	2,815,858	2,696,163	2,834,299	3,365,525	4,503,637
71—Power generating machinery	2,373,450	2,407,663	2,690,280	3,101,498	4,130,631
87—Professional, scientific	2,110,802	2,151,876	2,265,536	2,504,206	3,044,757
72—Machinery	1,836,766	1,867,851	1,838,274	2,032,065	2,822,881
89—Miscellaneous manufactures	1,304,494	1,244,042	1,488,580	1,869,249	2,602,260
74—General industrial machinery	1,532,456	1,478,308	1,537,973	1,700,616	2,330,536
78—Road vehicles	931,091	932,943	1,039,616	1,340,664	2,077,201
22—Oil seeds and oleaginous fruit	2,763,811	1,823,815	2,111,317	2,152,758	2,059,333
Total of items shown	25,188,697	24,563,528	26,995,624	31,541,124	40,409,874
Total other	23,041,112	22,149,218	23,256,211	25,688,953	30,895,750
Total all commodities	48,229,809	46,712,746	50,251,834	57,230,077	71,305,625

Note.—Top 10 commodities sorted by domestic exports, f.a.s. value in 1988.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-5

SITC rev 2 commodity 22—Oil seeds and oleaginous fruit: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	266,510	115,074	202,528	179,220	143,890
Denmark	28,670	15,814	12,142	8,887	13,650
France	177,714	73,158	90,950	93,404	64,540
Greece	39,897	44,830	41,613	43,560	60,516
Ireland	0	0	737	947	97
Italy	178,167	148,601	167,334	102,515	48,093
Netherlands	1,030,187	715,113	739,519	850,574	882,628
Portugal	237,862	131,769	114,675	123,494	98,056
Spain	446,498	257,389	359,897	339,212	310,789
United Kingdom	120,660	120,659	135,590	105,418	173,397
West Germany	237,646	201,410	246,333	305,528	263,676
Total	2,763,811	1,823,815	2,111,317	2,152,758	2,059,333
Canada	132,019	78,488	82,286	75,739	65,824
Japan	1,199,291	962,120	863,541	810,877	1,055,912
All other	2,095,075	1,444,945	1,601,634	1,577,541	1,881,594
Grand total	6,190,195	4,309,369	4,658,778	4,616,916	5,062,663

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-6

SITC rev 2 commodity 71—Power-generating machinery: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	330,536	314,733	276,502	277,998	381,564
Denmark	23,960	17,933	13,967	18,025	30,575
France	872,154	860,234	918,717	1,055,939	1,368,066
Greece	10,812	8,120	7,268	9,409	12,613
Ireland	29,045	37,720	56,314	53,786	102,224
Italy	161,229	127,257	148,127	117,372	184,044
Netherlands	160,523	125,036	179,737	209,139	292,798
Portugal	2,142	6,517	14,161	7,671	12,618
Spain	73,742	74,949	106,978	113,471	116,256
United Kingdom	437,122	526,907	584,393	774,077	1,099,512
West Germany	272,185	308,256	384,116	464,612	530,361
Total	2,373,450	2,407,663	2,690,280	3,101,498	4,130,631
Canada	2,649,741	2,731,524	2,422,690	2,648,898	3,080,829
Japan	624,754	437,444	502,163	551,295	729,252
All other	3,663,002	3,883,178	3,689,971	4,058,116	5,108,406
Grand total	9,310,948	9,459,809	9,305,104	10,359,808	13,049,118

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-7

SITC rev 2 commodity 72—Machinery specialized: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	186,189	179,131	171,817	191,329	272,433
Denmark	18,446	20,310	27,598	39,371	41,876
France	260,322	268,908	288,065	350,313	475,758
Greece	33,653	27,780	12,601	17,212	43,691
Ireland	38,016	40,942	30,412	32,899	49,140
Italy	161,340	144,398	153,178	170,763	236,826
Netherlands	166,374	173,947	170,989	193,547	258,670
Portugal	8,222	11,048	9,303	17,897	21,154
Spain	46,698	49,616	65,995	108,810	145,655
United Kingdom	591,203	576,904	495,136	531,622	784,908
West Germany	326,302	374,868	413,179	378,300	492,769
Total	1,836,766	1,867,851	1,838,274	2,032,065	2,822,881
Canada	1,942,486	1,889,668	1,700,476	2,011,285	2,158,576
Japan	634,868	578,405	487,290	429,854	765,042
All other	5,255,237	5,590,291	5,151,491	4,769,927	6,148,961
Grand total	9,669,358	9,926,216	9,177,531	9,243,131	11,895,460

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-8

SITC rev 2 commodity 74—General industrial machinery: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	134,706	133,566	128,476	159,103	213,215
Denmark	22,207	18,177	21,517	22,292	26,647
France	222,063	204,071	217,951	220,495	322,272
Greece	12,689	11,939	13,260	16,929	21,498
Ireland	46,799	49,319	47,327	64,213	90,699
Italy	98,496	106,356	123,763	143,640	227,243
Netherlands	129,067	124,187	139,008	157,256	189,271
Portugal	7,722	6,622	7,224	8,443	12,071
Spain	64,065	52,886	60,758	86,107	127,838
United Kingdom	447,142	454,848	449,048	483,533	635,429
West Germany	347,500	316,337	329,640	338,605	464,354
Total	1,532,456	1,478,308	1,537,973	1,700,616	2,330,536
Canada	2,148,584	2,071,713	1,821,807	2,312,634	2,648,479
Japan	324,656	336,547	334,607	386,899	611,894
All other	4,185,745	3,794,943	3,592,186	3,979,873	5,225,092
Grand total	8,191,442	7,681,511	7,286,574	8,380,022	10,816,002

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-9

SITC rev 2 commodity 75—Office machines: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	245,239	275,616	344,685	390,124	524,874
Denmark	80,057	74,863	74,509	102,660	90,416
France	883,919	912,450	949,665	1,076,597	1,331,883
Greece	15,027	13,378	13,684	13,909	16,421
Ireland	548,098	531,070	583,030	673,513	644,059
Italy	411,191	418,663	488,711	690,633	894,338
Netherlands	931,459	812,073	867,748	978,249	1,419,126
Portugal	41,047	34,122	45,928	43,510	55,428
Spain	138,411	150,428	166,047	232,089	236,940
United Kingdom	2,042,085	1,823,949	1,864,914	2,278,880	3,027,991
West Germany	1,346,323	1,396,852	1,565,367	1,850,224	2,217,438
Total	6,682,855	6,443,464	6,964,288	8,330,389	10,458,914
Canada	2,247,329	2,345,331	2,120,168	2,833,962	2,768,910
Japan	1,110,765	1,303,225	1,373,587	1,699,473	2,416,631
All other	4,509,070	4,796,828	4,956,101	5,776,920	7,418,596
Grand total	14,550,019	14,888,849	15,414,145	18,640,745	23,063,050

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-10

SITC rev 2 commodity 77—Electrical machinery: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	108,244	114,082	126,461	148,941	170,348
Denmark	31,532	29,728	35,771	35,280	42,603
France	373,881	395,737	429,815	515,218	721,771
Greece	8,662	7,500	8,401	9,566	14,250
Ireland	81,641	89,353	88,797	112,815	190,151
Italy	186,452	165,464	209,323	263,698	445,663
Netherlands	307,782	276,794	298,494	322,123	398,370
Portugal	12,398	11,175	17,201	30,480	35,004
Spain	63,443	61,907	78,646	91,811	151,115
United Kingdom	920,886	863,634	838,203	1,016,823	1,322,325
West Germany	720,937	680,790	703,187	818,769	1,012,037
Total	2,815,858	2,696,163	2,834,299	3,365,525	4,503,637
Canada	2,127,607	1,986,541	2,021,943	2,583,920	3,202,288
Japan	906,460	803,636	945,478	1,207,718	1,657,595
All other	7,831,881	6,812,783	7,637,009	9,250,973	11,943,373
Grand total	13,681,805	12,299,123	13,438,730	16,408,136	21,306,893

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-11

SITC rev 2 commodity 78—Road vehicles: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	222,179	210,973	226,817	244,029	385,563
Denmark	2,396	2,045	4,742	6,623	11,573
France	133,574	126,608	142,205	277,126	379,111
Greece	5,490	5,322	5,852	6,503	8,103
Ireland	5,278	1,771	2,267	2,203	3,788
Italy	32,210	50,508	52,797	76,789	86,164
Netherlands	33,412	28,817	45,005	73,000	113,792
Portugal	3,666	2,593	4,253	3,313	3,156
Spain	25,492	19,052	25,771	35,366	37,884
United Kingdom	211,810	204,589	215,355	233,220	360,657
West Germany	255,584	280,665	314,552	382,493	687,411
Total	931,091	932,943	1,039,616	1,340,664	2,077,201
Canada	12,990,598	14,574,040	13,917,278	15,041,713	16,569,079
Japan	189,254	209,656	269,282	329,951	673,993
All other	3,509,651	3,689,222	3,453,208	4,342,435	6,065,647
Grand total	17,620,594	19,405,862	18,679,385	21,054,762	25,385,921

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-12

SITC rev 2 commodity 79—Other transport equipment: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	134,938	129,162	283,241	329,733	301,041
Denmark	52,921	103,410	116,761	172,732	123,727
France	217,470	228,785	637,428	399,211	794,182
Greece	24,390	25,145	19,229	24,089	45,444
Ireland	21,782	19,706	22,100	99,629	27,691
Italy	387,850	661,674	452,898	424,206	540,260
Netherlands	235,049	145,756	500,542	473,197	559,684
Portugal	90,588	36,852	70,290	37,915	84,835
Spain	124,292	144,753	203,168	466,400	683,136
United Kingdom	1,008,839	1,219,367	883,426	1,726,357	2,104,246
West Germany	538,995	802,794	1,036,377	990,682	1,115,479
Total	2,837,113	3,517,403	4,225,459	5,144,153	6,379,725
Canada	848,312	731,530	806,881	852,875	1,477,016
Japan	1,134,498	1,503,718	1,865,299	1,952,566	2,237,102
All other	7,183,799	9,592,857	9,311,947	10,005,450	11,254,433
Grand total	12,003,722	15,345,508	16,209,587	17,955,044	21,348,276

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-13

SITC rev 2 commodity 87—Professional, scientific apparatus: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	90,818	70,059	86,335	95,182	119,776
Denmark	39,365	38,755	29,650	34,837	33,394
France	293,443	312,381	359,160	416,858	528,829
Greece	20,005	18,380	17,738	13,168	19,653
Ireland	72,452	74,703	78,091	82,803	93,128
Italy	184,541	175,372	208,150	265,860	322,891
Netherlands	220,627	235,628	241,736	271,213	304,585
Portugal	5,999	5,613	4,950	9,424	23,603
Spain	69,637	73,754	77,643	88,584	120,033
United Kingdom	657,762	657,462	619,178	631,256	792,658
West Germany	456,153	489,769	542,906	595,021	686,206
Total	2,110,802	2,151,876	2,265,536	2,504,206	3,044,757
Canada	903,901	900,829	824,936	984,758	1,099,669
Japan	645,349	675,118	737,192	908,901	1,284,151
All other	2,582,778	2,816,199	2,946,964	3,040,171	3,514,044
Grand total	6,242,831	6,544,021	6,774,628	7,438,036	8,942,621

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-14

SITC rev 2 commodity 89—Miscellaneous manufactures: SITC-based U.S. exports to the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	F.a.s. value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	55,177	43,498	79,461	96,057	104,765
Denmark	27,486	36,405	44,262	50,786	57,528
France	151,990	163,114	195,476	257,775	322,513
Greece	6,320	5,719	4,254	6,257	9,321
Ireland	70,160	46,963	42,999	47,333	81,307
Italy	68,348	71,410	86,997	123,282	170,979
Netherlands	157,829	151,646	184,931	205,869	274,863
Portugal	2,511	2,649	3,184	5,849	7,791
Spain	20,844	26,957	36,061	46,329	73,493
United Kingdom	506,057	480,972	504,372	639,863	951,002
West Germany	237,773	214,709	306,582	389,850	548,698
Total	1,304,494	1,244,042	1,488,580	1,869,249	2,602,260
Canada	1,295,120	1,149,285	1,167,510	1,486,992	1,749,095
Japan	426,640	399,771	560,144	854,621	1,172,872
All other	1,849,562	1,766,433	1,984,154	2,330,745	3,235,319
Grand total	4,875,816	4,559,531	5,200,389	6,541,608	8,759,545

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-15

U.S. imports for consumption from the EC, by principal categories, 1984-88

SITC rev 2 commodity	1984	1985	1986	1987	1988
	Customs (1,000 dollars)				
78—Road vehicles	7,665,886	9,958,268	11,984,485	13,704,642	11,165,694
72—Machinery	3,358,691	3,769,353	5,002,963	5,453,612	6,166,416
89—Miscellaneous manufactures	3,187,367	3,974,474	4,484,605	4,442,214	4,744,838
77—Electrical machinery	2,271,267	2,572,981	3,288,682	3,603,810	4,267,985
74—General industrial machinery	2,190,471	2,517,184	3,291,576	3,538,370	4,086,678
71—Power generating machinery	2,103,066	3,059,855	3,707,033	3,684,802	3,943,376
66—Non-metallic minerals	2,272,467	2,489,649	2,903,009	3,173,591	3,660,862
33—Petroleum, petroleum products	6,611,323	5,495,280	3,648,309	3,997,145	3,650,525
79—Other transport equipment	1,882,148	2,264,177	2,722,741	2,882,416	3,361,024
67—Iron and steel	3,098,324	3,051,409	2,609,446	2,495,330	3,157,338
Total of items shown	34,641,011	39,152,629	43,642,848	46,975,931	48,204,735
Total other	25,081,144	28,400,154	31,831,489	33,168,417	35,831,469
Total all commodities	59,722,155	67,552,783	75,474,337	80,144,348	84,036,204

Note.—Top 10 commodities sorted by imports for consumption, customs value in 1988.

Source Compiled from official statistics of the U.S. Department of Commerce.

Table E-16

SITC rev 2 commodity 33—Petroleum, petroleum products: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	1984	1985	1986	1987	1988
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	251,050	158,128	88,058	288,346	188,710
Denmark	61	16	4,452	5,395	7,124
France	100,988	150,687	112,222	71,645	159,284
Greece	86,977	108,975	75,988	81,511	136,006
Ireland	15	1	20	3,809	4,429
Italy	475,348	743,630	567,553	441,610	392,839
Netherlands	1,090,673	653,579	425,346	413,836	483,155
Portugal	6,228	2,079	2,432	2,529	43,470
Spain	146,465	329,505	354,327	338,002	455,469
United Kingdom	4,383,554	3,251,643	1,945,907	2,306,754	1,715,511
West Germany	69,964	97,035	72,005	43,707	64,530
Total	6,611,323	5,495,280	3,648,309	3,997,145	3,650,525
Canada	4,963,004	6,166,932	3,970,336	4,411,090	4,368,342
Japan	23,848	29,792	55,955	53,408	44,075
All other	43,932,166	37,548,067	26,089,265	32,392,258	29,429,967
Grand total	55,530,342	49,240,071	33,763,865	40,853,901	37,492,908

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-17

SITC rev 2 commodity 66—Nonmetallic mineral: SITC-based U.S. Imports for consumption from the European Community, Canada, Japan, and all other, 1984-1988

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	885,726	838,730	982,885	986,266	1,152,484
Denmark	18,562	21,351	20,462	19,923	18,081
France	196,079	204,199	257,564	271,577	299,300
Greece	1,908	13,781	35,218	51,241	82,397
Ireland	54,104	62,549	63,654	62,606	105,428
Italy	341,462	412,614	535,664	620,474	674,732
Netherlands	76,198	94,461	69,527	52,763	66,669
Portugal	20,787	25,671	28,959	37,827	40,644
Spain	106,508	156,261	195,181	197,991	195,505
United Kingdom	272,163	331,922	353,633	490,880	648,357
West Germany	298,968	328,109	360,263	382,042	377,264
Total	2,272,467	2,489,649	2,903,009	3,173,591	3,660,862
Canada	534,507	590,773	675,638	721,173	730,456
Japan	853,740	920,839	898,612	832,693	896,221
All other	3,231,405	3,388,982	3,975,278	4,192,675	4,942,738
Grand total	6,892,118	7,390,243	8,452,538	8,920,131	10,230,277

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-18

SITC rev 2 commodity 67—Iron and steel: SITC-based U.S. Imports for consumption from the European Community, Canada, Japan, and all other, 1984-1988

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	312,719	358,525	346,447	293,855	397,673
Denmark	1,255	3,351	3,018	2,073	5,465
France	544,040	653,516	519,455	522,928	688,090
Greece	60,700	56,546	37,962	38,252	34,556
Ireland	168	96	2,334	232	272
Italy	310,522	310,221	214,295	228,359	229,380
Netherlands	154,120	188,279	158,210	162,471	212,767
Portugal	25,340	46,617	14,024	14,299	9,448
Spain	428,183	192,385	217,671	191,181	242,909
United Kingdom	234,255	287,885	268,469	274,623	366,375
West Germany	1,027,023	953,988	827,562	767,057	970,401
Total	3,098,324	3,051,409	2,609,446	2,495,330	3,157,338
Canada	1,335,511	1,213,186	1,264,593	1,560,317	1,608,253
Japan	3,158,557	3,044,428	2,193,260	2,178,022	2,594,526
All other	3,247,793	2,905,407	2,600,714	2,767,122	3,973,133
Grand total	10,840,185	10,214,429	8,668,012	9,000,791	11,333,249

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-19

SITC rev 2 commodity 71—Power-generating machinery: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	30,658	75,190	63,339	73,250	77,898
Denmark	58,773	149,509	109,442	36,158	22,978
France	663,376	970,988	1,314,854	1,094,225	1,232,074
Greece	117	134	145	702	109
Ireland	1,831	7,808	4,083	5,186	9,301
Italy	100,078	118,296	167,221	185,541	216,350
Netherlands	24,434	25,599	36,651	35,429	38,383
Portugal	199	617	1,383	579	2,167
Spain	12,819	17,987	21,364	19,654	21,943
United Kingdom	724,795	1,030,029	1,040,994	1,123,098	1,077,334
West Germany	485,985	663,697	947,558	1,110,980	1,244,839
Total	2,103,066	3,059,855	3,707,033	3,684,802	3,943,376
Canada	2,342,839	2,239,808	2,098,075	2,290,819	2,679,896
Japan	936,080	1,075,550	1,383,225	1,609,982	1,934,297
All other	1,431,959	1,777,477	1,780,432	2,104,621	2,503,687
Grand total	6,813,944	8,152,690	8,968,765	9,690,224	11,061,256

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-20

SITC rev 2 commodity 72—Machinery, specialized: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	135,530	202,765	226,745	200,832	273,726
Denmark	47,649	57,738	94,649	70,267	91,384
France	277,885	321,093	442,798	552,389	606,140
Greece	326	1,055	492	1,910	1,924
Ireland	15,985	19,113	19,050	18,486	16,835
Italy	435,274	457,432	598,079	627,253	790,430
Netherlands	144,906	182,579	220,504	248,001	247,602
Portugal	8,484	8,683	11,146	12,893	13,867
Spain	32,339	34,184	41,091	50,255	47,133
United Kingdom	657,841	714,945	941,333	1,027,338	1,189,533
West Germany	1,602,471	1,769,766	2,407,075	2,643,987	2,887,841
Total	3,358,691	3,769,353	5,002,963	5,453,612	6,166,416
Canada	1,372,261	1,119,858	1,071,911	1,426,688	1,638,392
Japan	1,657,438	2,050,655	2,480,849	2,915,436	3,343,584
All other	1,097,247	1,223,211	1,379,647	1,665,541	1,982,019
Grand total	7,485,638	8,163,076	9,935,370	11,461,278	13,130,411

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-21

SITC rev 2 commodity 74—General industrial machinery: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	63,822	80,351	95,290	107,062	133,433
Denmark	48,982	44,665	62,177	68,960	75,742
France	178,163	186,406	252,294	261,434	309,079
Greece	9	389	972	842	457
Ireland	20,535	41,958	43,452	33,659	48,173
Italy	352,713	410,758	531,216	602,625	627,072
Netherlands	58,094	57,454	94,455	95,671	106,935
Portugal	37,428	41,625	37,901	45,596	40,127
Spain	25,999	39,143	43,176	50,341	60,171
United Kingdom	461,923	502,877	579,827	668,115	860,264
West Germany	942,804	1,111,558	1,550,817	1,604,065	1,825,225
Grand total	2,190,471	2,517,184	3,291,576	3,538,370	4,086,678
Canada	1,072,038	1,104,200	1,104,653	1,176,892	1,294,770
Japan	1,695,948	2,184,948	2,530,381	2,943,363	3,129,763
All other	1,624,306	1,868,962	2,159,318	2,758,905	3,497,130
Total	6,582,762	7,675,294	9,085,928	10,417,530	12,008,341

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-22

SITC rev 2 commodity 77—Electrical machinery: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	41,670	48,945	54,631	61,181	60,597
Denmark	68,131	68,997	79,024	93,970	70,491
France	305,581	372,118	463,051	487,307	489,367
Greece	100	276	1,938	394	204
Ireland	123,019	119,422	139,427	138,231	192,298
Italy	200,343	173,073	231,613	230,943	277,057
Netherlands	199,792	201,583	238,412	255,454	317,478
Portugal	10,949	9,657	10,635	15,004	15,905
Spain	31,973	41,170	50,710	76,377	80,892
United Kingdom	400,620	469,286	611,351	705,399	883,338
West Germany	889,090	1,068,454	1,407,889	1,539,551	1,880,357
Total	2,271,267	2,572,981	3,288,682	3,603,810	4,267,985
Canada	1,287,475	1,306,256	1,472,989	1,826,649	2,147,663
Japan	4,882,776	4,652,776	5,285,073	6,342,174	8,479,290
All other	9,845,998	9,130,482	10,032,774	12,421,961	15,964,434
Grand total	18,287,517	17,662,495	20,079,518	24,194,594	30,859,371

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-23

SITC rev 2 commodity 78—Road vehicles: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	160,198	193,978	211,347	365,967	379,578
Denmark	3,217	4,018	4,680	5,922	9,114
France	894,106	829,311	781,309	942,318	884,601
Greece	86	552	294	278	2,448
Ireland	667	8,881	4,681	4,994	5,556
Italy	359,137	378,437	438,348	557,179	538,295
Netherlands	28,813	21,950	18,152	20,126	28,211
Portugal	514	5,052	8,853	8,561	7,127
Spain	68,044	67,478	85,191	107,915	149,387
United Kingdom	782,607	958,192	1,117,259	1,580,033	1,399,422
West Germany	5,368,498	7,490,420	9,314,372	10,111,349	7,761,956
Total	7,665,886	9,958,268	11,984,485	13,704,642	11,165,694
Canada	19,178,273	20,771,186	20,868,457	20,495,129	24,783,990
Japan	17,909,145	23,777,418	32,188,070	31,958,388	30,719,238
All other	2,570,517	3,629,751	5,498,931	8,270,194	9,198,101
Grand total	47,323,821	58,136,623	70,539,942	74,428,353	75,867,022

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-24

SITC rev 2 commodity 79—Other transport equipment: SITC-based U.S. imports from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	23,222	24,531	32,656	23,403	18,292
Denmark	34,274	20,902	18,450	13,984	21,403
France	536,484	806,132	875,160	1,100,598	1,494,602
Greece	32	473	271	152	172
Ireland	1,096	1,651	1,744	4,496	1,569
Italy	212,699	201,362	259,740	283,882	315,136
Netherlands	128,389	232,303	282,917	115,522	172,413
Portugal	7,634	3,283	6,625	575	4,246
Spain	21,925	30,135	29,805	36,086	58,388
United Kingdom	656,725	773,037	1,048,868	1,095,837	1,057,389
West Germany	259,667	170,368	166,506	207,881	217,414
Total	1,882,148	2,264,177	2,722,741	2,882,416	3,361,024
Canada	984,716	1,155,856	1,564,624	1,424,451	1,538,992
Japan	363,924	275,172	284,407	498,821	567,017
All other	544,333	673,833	914,094	881,550	856,327
Grand total	3,775,121	4,369,038	5,485,866	5,687,238	6,323,359

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-25

SITC rev 2 commodity 89—Miscellaneous manufactures: SITC-based U.S. imports for consumption from the European Community, Canada, Japan, and all other, 1984-88

Partners	*1984*	*1985*	*1986*	*1987*	*1988*
	Customs value (1,000 dollars)				
European Community:					
Belgium and Luxembourg	66,626	68,259	96,681	177,563	224,784
Denmark	70,476	78,451	86,449	82,647	108,331
France	436,284	467,380	556,339	539,407	616,021
Greece	19,654	16,675	12,042	13,028	11,249
Ireland	27,654	32,870	46,718	47,371	43,947
Italy	971,644	1,359,007	1,429,281	1,383,206	1,456,943
Netherlands	102,515	141,606	142,007	111,590	104,178
Portugal	17,908	21,624	17,536	17,949	17,816
Spain	109,889	137,025	137,020	128,927	133,330
United Kingdom	845,460	1,065,706	1,179,334	1,172,053	1,219,625
West Germany	519,256	585,868	781,197	768,472	808,613
Total	3,187,367	3,974,474	4,484,605	4,442,214	4,744,838
Canada	1,181,351	1,169,494	1,253,206	1,348,692	1,508,538
Japan	1,746,738	2,318,273	2,704,045	2,964,019	3,670,753
All other	6,170,582	6,938,641	8,310,006	10,433,575	11,145,571
Grand total	12,286,037	14,400,882	16,751,861	19,188,499	21,069,700

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table E-26

All commodities: EC exports, by leading markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
West Germany	72,496,638	76,974,497	96,214,880	114,949,688
France	63,590,880	66,586,957	84,319,586	105,133,099
United States	57,582,372	65,014,752	73,406,724	81,277,348
United Kingdom	46,228,860	49,386,249	62,500,549	76,947,436
Italy	36,769,165	39,736,634	52,560,772	67,047,485
Netherlands	39,604,231	43,324,589	52,138,690	63,305,009
Belgium and Luxembourg	36,797,505	38,701,153	50,301,527	61,112,775
Switzerland	20,759,457	22,093,968	30,556,873	37,433,774
Spain	10,637,239	11,989,726	19,333,033	28,552,254
Austria	12,685,374	13,763,116	18,949,497	23,188,592
Sweden	14,644,159	15,832,476	18,709,710	23,145,318
Japan	7,373,108	7,909,085	11,220,690	15,625,915
Denmark	8,182,134	9,286,978	12,230,284	13,532,239
Norway	6,460,055	7,267,984	9,858,418	10,899,599
Soviet Union	9,839,763	9,509,898	9,693,321	10,526,355
All other	163,948,730	166,524,783	186,357,570	218,151,354
Total	607,599,665	643,902,843	788,354,610	950,831,202

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-27

SITC division 71—Machinery, nonelectric: EC exports, by leading markets,1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	9,086,452	11,360,945	14,198,569	16,107,955
France	7,713,041	8,684,401	11,737,446	15,416,687
West Germany	6,286,549	7,192,507	9,924,560	12,271,845
United Kingdom	6,201,094	6,949,627	9,002,225	11,664,547
Italy	3,682,178	4,310,897	5,974,401	8,284,272
Netherlands	3,815,783	4,528,061	6,031,648	7,452,177
Belgium and Luxembourg	3,065,665	3,494,894	4,972,419	6,166,775
Spain	2,013,673	2,319,978	3,622,780	5,514,384
Switzerland	2,308,876	2,647,681	4,066,899	5,261,564
Sweden	2,376,756	2,675,120	3,277,570	4,187,893
Austria	1,896,673	2,177,792	3,184,706	3,851,040
Denmark	1,170,604	1,449,418	2,099,822	2,261,737
China	626,452	1,545,346	2,581,063	2,198,507
Soviet Union	2,018,957	1,561,206	2,110,632	2,162,252
Norway	1,069,449	1,287,495	1,905,368	2,043,639
All other	28,105,800	29,501,890	35,207,793	40,345,860
Total	81,438,004	91,687,257	119,898,001	145,191,382

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-28

SITC division 73—Transport equipment: EC exports, by leading markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	10,634,280	12,384,889	15,451,029	16,705,382
France	9,066,981	9,027,676	11,415,395	14,824,550
United Kingdom	6,624,233	7,232,155	9,740,655	12,151,521
West Germany	6,007,289	6,220,632	9,506,991	11,707,478
Italy	4,382,976	5,046,140	7,061,037	9,733,319
Belgium and Luxembourg	4,410,561	4,799,493	7,206,045	9,507,943
Spain	1,716,254	1,958,756	3,523,177	6,803,033
Netherlands	2,921,781	3,321,908	4,726,884	5,810,515
Special Categories	8,478	9,436	11,551	5,417,412
Switzerland	1,798,948	2,016,052	3,129,889	3,847,710
Sweden	1,393,763	1,499,114	2,178,623	3,134,473
Austria	1,420,330	1,580,499	2,406,697	2,798,238
Japan	562,782	741,443	1,241,000	2,297,140
Norway	748,152	961,777	1,349,665	1,258,894
Portugal	362,701	418,194	690,235	1,252,410
All other	19,945,986	18,174,743	20,093,262	20,284,932
Total	72,005,502	75,392,904	99,732,146	127,536,763

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-29

SITC division 72—Electrical machinery: EC exports, by leading markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
West Germany	4,172,640	4,663,789	6,266,844	7,766,879
France	3,765,129	4,006,097	5,781,592	7,691,695
Italy	2,505,951	2,826,744	4,147,863	5,618,708
United States	3,208,477	3,889,571	4,709,327	5,372,857
United Kingdom	3,118,417	3,354,849	4,332,717	5,351,058
Netherlands	2,328,414	2,590,381	3,569,107	4,359,018
Belgium and Luxembourg	1,738,355	1,967,935	2,969,320	3,581,926
Switzerland	1,269,545	1,465,709	2,218,178	2,927,826
Sweden	1,307,062	1,529,343	1,912,023	2,375,567
Austria	1,137,361	1,269,610	1,784,735	2,292,983
Spain	807,312	904,260	1,510,067	2,177,431
Denmark	591,590	723,046	1,038,825	1,184,263
Norway	576,430	709,594	978,295	1,107,876
India	281,354	424,139	701,170	896,363
Finland	426,795	478,248	689,742	890,909
All other	14,636,966	15,316,926	18,194,808	20,732,280
Total	41,871,801	46,120,239	60,804,630	74,327,702

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-30

SITC division 51—Chemical elements, compounds: EC exports, by leading markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
West Germany	3,319,278	3,547,726	4,051,808	4,693,603
Belgium and Luxembourg	2,787,012	2,912,880	3,414,185	3,894,078
Netherlands	2,660,848	2,837,891	2,876,660	3,426,958
United States	2,921,673	3,075,936	3,023,242	3,335,820
France	2,195,648	2,266,575	2,602,357	2,940,566
United Kingdom	1,880,391	1,989,734	2,530,670	2,912,370
Italy	1,734,010	1,896,196	2,287,786	2,664,885
Switzerland	1,009,041	1,134,094	1,386,752	1,545,764
Japan	882,087	887,461	1,179,008	1,493,861
Special Categories	73,963	370,984	106,953	1,360,762
Spain	709,502	726,365	1,037,157	1,220,446
Sweden	351,856	436,051	479,648	604,258
Soviet Union	475,350	458,530	452,331	562,346
Austria	342,523	372,838	452,680	530,289
Korea; South	233,969	266,535	353,560	467,029
All other	7,138,284	7,199,301	7,766,046	9,014,747
Total	28,715,430	30,379,100	34,000,851	40,667,787

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-31

SITC division 89—Miscellaneous manufactured goods: EC exports, by leading markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
France	2,369,888	2,468,644	3,782,837	4,988,283
United States	2,951,825	3,691,446	4,259,511	4,627,403
West Germany	1,870,744	1,936,197	2,782,523	3,637,972
United Kingdom	1,785,558	2,071,137	2,777,789	3,534,966
Switzerland	1,704,327	1,799,565	2,491,206	3,189,109
Netherlands	1,407,650	1,555,425	2,274,485	2,841,285
Belgium and Luxembourg	1,220,078	1,293,952	1,884,841	2,448,985
Italy	710,778	815,188	1,295,827	1,677,851
Austria	715,873	766,547	1,113,268	1,463,406
Sweden	470,257	534,731	758,245	1,013,443
Japan	337,146	401,607	615,755	1,013,145
Spain	297,466	322,573	545,370	880,055
Denmark	268,156	320,642	501,171	618,919
Norway	255,511	304,181	435,869	497,670
Ireland	254,893	284,973	379,704	477,901
All other	5,291,716	5,322,294	6,133,179	7,171,837
Total	21,911,865	23,889,103	32,031,714	40,082,272

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-32

All commodities: EC imports, by leading sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
West Germany	79,136,558	85,888,647	117,280,728	147,217,183
France	51,584,439	54,816,141	71,138,298	88,461,384
Netherlands	50,431,899	52,740,729	61,542,862	71,546,641
United States	52,374,629	53,007,909	56,787,541	65,043,853
Italy	34,529,882	36,667,885	51,063,347	64,068,714
Belgium and Luxembourg	35,228,562	37,531,481	49,612,601	61,152,922
United Kingdom	42,219,770	46,105,845	49,190,910	60,304,835
Japan	20,986,038	22,643,583	33,962,336	41,901,758
Switzerland	16,095,420	16,315,882	23,244,619	28,819,986
Sweden	14,526,284	14,897,504	19,015,230	23,163,563
Spain	12,196,115	13,405,294	17,096,184	22,345,427
Austria	8,900,349	9,767,230	13,744,330	17,547,546
Soviet Union	18,333,752	15,810,164	13,688,734	14,844,121
Norway	12,947,662	13,784,154	12,058,380	14,081,981
Denmark	7,203,958	7,774,426	10,013,085	12,442,462
All other	176,717,073	178,696,414	177,377,067	216,730,831
Total	633,412,390	659,853,291	776,818,196	949,673,522

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-33

SITC division 71—Machinery, nonelectric: EC imports, by leading sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
West Germany	12,541,821	14,076,842	20,303,840	25,842,667
United States	13,077,108	13,679,515	14,944,684	17,887,223
Italy	4,835,794	5,556,238	7,885,379	10,443,139
France	4,986,599	5,474,274	7,515,415	9,645,763
United Kingdom	4,836,551	5,789,583	7,031,809	9,190,206
Japan	3,637,993	4,293,605	6,835,821	8,942,653
Switzerland	2,361,542	2,688,266	4,087,739	5,186,858
Netherlands	2,632,942	2,981,049	4,067,402	5,116,992
Belgium and Luxembourg	2,032,516	2,551,478	3,435,295	4,372,125
Sweden	1,936,221	2,135,356	2,850,326	3,672,232
Austria	1,178,135	1,346,388	2,052,656	2,737,861
Ireland	1,179,065	1,374,372	1,818,928	2,542,092
Spain	979,668	1,202,215	1,647,672	2,153,701
Denmark	805,447	872,248	1,196,527	1,560,269
Taiwan	356,324	431,207	738,279	1,483,089
All other	4,043,053	4,552,486	5,779,159	7,769,344
Total	61,420,780	69,005,116	92,190,935	118,546,213

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-34

SITC division 73—Transport equipment: EC imports, by leading sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
West Germany	13,003,428	14,461,146	20,820,292	27,863,692
France	8,337,636	8,388,328	10,871,340	14,663,208
Japan	5,261,070	5,189,940	8,578,501	10,208,080
Belgium and Luxembourg	4,238,415	4,675,257	7,637,136	10,007,434
Italy	2,704,930	2,789,216	4,430,857	5,971,946
Spain	2,624,577	3,142,943	4,055,316	5,012,907
United Kingdom	2,492,142	2,516,808	3,388,315	4,500,260
United States	3,177,735	4,038,795	4,387,560	4,047,537
Sweden	1,566,241	1,653,895	2,735,695	3,157,795
Netherlands	1,409,843	1,434,996	2,069,938	2,939,739
Special Categories	159,488	214,819	278,348	2,828,742
Austria	376,904	400,299	669,720	887,813
Switzerland	225,621	354,277	462,196	642,419
Yugoslavia	227,281	281,611	487,840	567,480
Brazil	238,789	249,248	202,756	490,488
All other	2,225,560	2,266,786	2,621,515	3,295,524
Total	48,269,657	52,058,366	73,697,319	97,085,064

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-35

SITC division 33—Petroleum and products: EC imports, by leading sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
United Kingdom	13,157,908	14,092,203	7,872,504	8,766,863
Soviet Union	12,040,609	9,819,874	5,722,891	7,847,467
Netherlands	8,083,021	8,514,119	6,192,364	6,786,246
Saudi Arabia	7,972,517	6,097,128	7,995,417	5,670,932
Libya	8,042,938	8,749,243	4,960,052	5,595,910
Norway	4,547,998	5,425,792	3,420,606	4,960,533
Iraq	4,097,157	4,887,458	2,994,044	4,023,071
Iran	6,924,542	4,901,618	2,497,372	3,816,930
Algeria	5,037,655	5,733,966	3,073,181	3,487,458
Nigeria	8,241,247	8,498,332	4,210,009	3,134,077
Kuwait	3,061,807	3,554,783	2,181,017	2,860,998
Mexico	3,721,153	3,600,680	1,515,492	2,480,034
Egypt	2,791,714	2,743,919	1,245,092	1,806,255
Belgium and Luxembourg	2,442,960	1,829,681	1,416,156	1,594,705
United Arab Emirates	2,888,128	1,415,205	536,637	1,336,139
All other	19,651,511	20,221,083	12,578,743	13,159,364
Total	112,702,873	110,085,084	68,411,575	77,326,980

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-36

SITC division 72—Electrical machinery: EC imports, by leading sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
West Germany	6,656,086	7,144,143	10,445,850	13,032,321
United States	6,441,265	6,651,393	6,952,539	8,071,581
Japan	3,651,812	4,216,657	6,117,373	7,914,788
France	2,962,350	3,335,561	4,516,535	5,968,629
Italy	2,469,085	2,572,981	3,682,959	4,657,693
United Kingdom	2,153,091	2,473,793	3,316,532	4,343,016
Netherlands	1,945,898	2,044,262	2,992,864	3,435,812
Belgium and Luxembourg	1,539,940	1,669,972	2,473,586	3,149,841
Switzerland	1,343,603	1,438,286	2,196,266	2,937,483
Austria	871,594	986,344	1,460,155	1,964,719
Sweden	759,812	918,330	1,168,249	1,605,167
Taiwan	676,231	660,921	962,280	1,530,356
Korea, South	354,011	408,110	741,596	1,398,071
Hong Kong	529,084	500,744	709,028	1,164,105
Spain	515,915	578,990	857,033	1,092,649
All other	4,497,903	4,770,493	6,132,357	8,507,107
Total	37,367,678	40,370,983	54,725,212	70,773,335

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-37

SITC division 89—Miscellaneous manufactured goods: EC imports, by leading sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
West Germany	2,908,441	3,311,816	4,964,887	6,237,910
Japan	3,258,678	3,342,059	4,600,559	5,557,246
United States	1,994,395	1,992,978	2,430,978	3,102,102
United Kingdom	1,247,627	1,384,250	1,996,009	2,693,465
Italy	1,448,138	1,491,732	2,114,730	2,671,095
France	1,336,586	1,440,271	2,018,727	2,641,628
Netherlands	1,197,040	1,298,890	1,885,686	2,438,488
Switzerland	1,029,491	1,058,088	1,525,994	1,983,743
Belgium and Luxembourg	914,683	1,037,427	1,599,623	1,873,406
Taiwan	491,555	486,787	765,089	1,348,367
Hong Kong	662,863	636,308	900,569	1,221,071
Austria	523,743	563,945	878,510	1,098,973
Korea, South	235,493	244,036	471,528	984,861
Denmark	338,981	371,391	557,485	767,807
Ireland	378,669	389,710	528,509	766,639
All other	2,044,796	1,996,028	2,887,197	4,108,731
Total	20,011,176	21,045,721	30,126,090	39,495,585

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-38

All commodities: EC exports, by leading external markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	57,582,372	65,014,75	73,406,724	81,277,348
Switzerland	20,759,457	22,093,968	30,556,873	37,433,774
Austria	12,685,374	13,763,116	18,949,497	23,188,592
Sweden	14,644,159	15,832,476	18,709,710	23,145,318
Japan	7,373,108	7,909,085	11,220,690	15,625,915
Norway	6,460,055	7,267,984	9,858,418	10,899,599
Soviet Union	9,839,763	9,509,898	9,693,321	10,526,355
Canada	6,195,757	7,586,087	8,988,273	10,252,754
Finland	4,423,065	4,895,352	6,435,701	8,070,943
Saudi Arabia	11,111,562	8,300,678	8,057,688	7,575,130
Special Categories	427,330	717,059	575,327	7,489,739
Turkey	3,375,402	4,111,275	4,643,868	6,428,610
Australia	4,764,609	5,465,462	5,721,209	6,372,901
India	3,765,324	4,360,934	5,601,284	6,283,398
China	2,917,582	5,458,232	6,399,130	6,239,104
All other	111,475,521	109,355,878	119,500,091	133,299,584
Total	277,800,436	291,642,236	338,317,805	394,109,057

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-39

SITC division 71—Machinery, nonelectric: EC exports, by leading external markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	9,086,452	11,360,94	14,198,569	16,107,955
Switzerland	2,308,876	2,647,681	4,066,899	5,261,564
Sweden	2,376,756	2,675,120	3,277,570	4,187,893
Austria	1,896,673	2,177,792	3,184,706	3,851,040
China	626,452	1,545,346	2,581,063	2,198,507
Soviet Union	2,018,957	1,561,206	2,110,632	2,162,252
Norway	1,069,449	1,287,495	1,905,368	2,043,639
Canada	1,035,330	1,293,824	1,683,296	1,945,023
Japan	821,885	912,523	1,286,998	1,710,368
Finland	907,011	1,004,480	1,333,303	1,707,221
Australia	1,095,009	1,384,431	1,426,438	1,553,303
Republic of South Africa	1,705,489	1,251,641	1,215,012	1,502,123
India	729,125	924,467	1,298,119	1,377,105
Turkey	761,816	896,188	1,173,227	1,335,244
Yugoslavia	780,294	886,024	1,256,953	1,289,562
All other	18,283,633	18,765,845	21,599,488	24,076,478
Total	45,503,210	50,575,008	63,597,641	72,309,266

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-40

SITC division 73—Transport equipment: EC exports, by leading external markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	10,634,280	12,384,88	15,451,029	16,705,382
Special Categories	8,478	9,436	11,551	5,417,412
Switzerland	1,798,948	2,016,052	3,129,889	3,847,710
Sweden	1,393,763	1,499,114	2,178,623	3,134,473
Austria	1,420,330	1,580,499	2,406,697	2,798,238
Japan	562,782	741,443	1,241,000	2,297,140
Norway	748,152	961,777	1,349,665	1,258,894
Canada	644,501	786,946	1,113,859	1,224,446
Finland	419,004	457,345	766,466	827,914
Republic of South Africa	936,268	525,200	567,447	783,274
Yugoslavia	375,665	481,986	647,267	751,533
Taiwan	161,082	294,573	277,727	745,082
Israel	253,542	261,106	420,861	685,108
Algeria	951,889	887,254	862,790	601,399
Turkey	402,047	670,324	616,539	541,263
All other	14,216,265	12,242,188	12,611,263	11,934,588
Total	34,927,003	35,800,132	43,652,673	53,553,853

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-41

SITC division 72—Electrical machinery: EC exports, by leading external markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	3,208,477	3,889,57	4,709,327	5,372,857
Switzerland	1,269,545	1,465,709	2,218,178	2,927,826
Sweden	1,307,062	1,529,343	1,912,023	2,375,567
Austria	1,137,361	1,269,610	1,784,735	2,292,983
Norway	576,430	709,594	978,295	1,107,876
India	281,354	424,139	701,170	896,363
Finland	426,795	478,248	689,742	890,909
Japan	355,300	453,740	625,761	777,375
Turkey	322,572	417,578	527,825	764,080
Republic of South Africa	679,060	634,783	595,422	748,131
Singapore	490,660	471,551	612,482	715,018
Soviet Union	424,659	427,402	602,630	668,646
Saudi Arabia	1,186,692	813,661	716,446	652,365
Australia	454,984	540,857	653,485	648,821
Canada	362,086	415,055	569,809	623,966
All other	9,325,897	10,031,522	11,758,194	13,179,172
Total	21,808,937	23,972,362	29,655,526	34,641,961

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-42

SITC division 89—Miscellaneous manufactured goods: EC exports, by leading external markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	2,951,825	3,691,44	4,259,511	4,627,403
Switzerland	1,704,327	1,799,565	2,491,206	3,189,109
Austria	715,873	766,547	1,113,268	1,463,406
Sweden	470,257	534,731	758,245	1,013,443
Japan	337,146	401,607	615,755	1,013,145
Norway	255,511	304,181	435,869	497,670
Canada	306,472	355,771	421,143	475,001
Saudi Arabia	704,603	580,589	467,250	461,515
Australia	314,664	343,183	366,799	424,125
Finland	151,046	169,345	241,610	319,482
Hong Kong	173,000	171,529	232,958	305,180
Brunei	116,315	42,761	155,965	288,136
Republic of South Africa	200,970	140,241	147,665	198,950
United Arab Emirates	227,675	186,502	129,820	191,949
Israel	78,898	91,163	139,858	178,915
All other	2,813,316	2,988,113	3,441,791	3,793,887
Total	11,521,896	12,567,274	15,418,711	18,441,320

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-43

SITC division 51—Chemical elements, compounds: EC exports, by leading external markets, 1984-87

(In thousands of dollars)

Market	*1984*	*1985*	*1986*	*1987*
United States	2,921,673	3,075,93	3,023,242	3,335,820
Switzerland	1,009,041	1,134,094	1,386,752	1,545,764
Japan	882,087	887,461	1,179,008	1,493,861
Special Categories	73,963	370,984	106,953	1,360,762
Sweden	351,856	436,051	479,648	604,258
Soviet Union	475,350	458,530	452,331	562,346
Austria	342,523	372,838	452,680	530,289
Korea, South	233,969	266,535	353,560	467,029
China	282,529	336,349	322,888	417,960
Taiwan	229,862	196,131	311,098	408,900
Turkey	240,843	231,366	315,528	397,522
Brazil	228,965	263,530	371,754	366,773
Yugoslavia	356,414	362,627	312,160	352,640
India	296,818	308,563	296,202	328,876
Canada	254,159	335,835	324,289	316,647
All other	4,378,519	4,288,966	4,495,023	5,198,879
Total	12,558,567	13,325,799	14,183,116	17,688,332

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-44

All commodities: EC imports, by leading external sources, 1984-87

(In thousands of dollars)

Source	1984	1985	1986	1987
United States	52,374,629	53,007,909	56,787,541	65,043,853
Japan	20,986,038	22,643,583	33,962,336	41,901,758
Switzerland	16,095,420	16,315,882	23,244,619	28,819,986
Sweden	14,526,284	14,897,504	19,015,230	23,163,563
Austria	8,900,349	9,767,230	13,744,330	17,547,546
Soviet Union	18,333,752	15,810,164	13,688,734	14,844,121
Norway	12,947,662	13,784,154	12,058,380	14,081,981
Finland	5,794,317	5,922,635	7,132,837	9,214,099
Brazil	7,441,133	7,957,014	7,212,166	8,317,050
Taiwan	3,154,899	3,151,159	4,794,805	7,904,660
Canada	6,101,000	5,736,789	6,398,826	7,884,276
Hong Kong	4,361,804	3,985,737	5,569,093	7,389,889
Korea, South	2,386,394	2,641,656	4,319,050	7,055,215
Saudi Arabia	8,711,648	6,724,401	8,748,030	6,505,632
Algeria	7,852,235	8,959,767	6,618,387	6,161,342
All other	117,988,302	119,699,648	108,716,807	132,945,951
Total	307,955,865	311,005,235	332,011,171	398,780,930

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-45

SITC division 33—Petroleum and products: EC imports, by leading external sources, 1984-87

(In thousands of dollars)

Source	1984	1985	1986	1987
Soviet Union	12,040,609	9,819,874	5,722,891	7,847,467
Saudi Arabia	7,972,517	6,097,128	7,995,417	5,670,932
Libya	8,042,938	8,749,243	4,960,052	5,595,910
Norway	4,547,998	5,425,792	3,420,606	4,960,533
Iraq	4,097,157	4,887,458	2,994,044	4,023,071
Iran	6,924,542	4,901,618	2,497,372	3,816,930
Algeria	5,037,655	5,733,966	3,073,181	3,487,458
Nigeria	8,241,247	8,498,332	4,210,009	3,134,077
Kuwait	3,061,807	3,554,783	2,181,017	2,860,998
Mexico	3,721,153	3,600,680	1,515,492	2,480,034
Egypt	2,791,714	2,743,919	1,245,092	1,806,255
United Arab Emirates	2,888,128	1,415,205	536,637	1,336,139
Venezuela	2,510,736	2,643,288	1,101,364	1,102,073
Romania	1,150,993	953,312	747,391	954,084
Sweden	1,237,804	986,663	602,092	827,793
All other	9,727,390	10,667,962	6,185,065	6,453,736
Total	83,994,394	80,679,223	48,987,722	56,357,489

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-46

SITC division 71—Machinery, nonelectric: EC imports, by leading external sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
United States	13,077,108	13,679,515	14,944,684	17,887,223
Japan	3,637,993	4,293,605	6,835,821	8,942,653
Switzerland	2,361,542	2,688,266	4,087,739	5,186,858
Sweden	1,936,221	2,135,356	2,850,326	3,672,232
Austria	1,178,135	1,346,388	2,052,656	2,737,861
Taiwan	356,324	431,207	738,279	1,483,089
Singapore	322,475	399,341	496,631	806,684
Canada	482,116	451,614	540,907	746,522
Korea, South	88,194	227,265	413,287	670,526
Finland	240,278	303,593	427,686	669,609
Norway	266,687	315,847	454,019	553,659
Hong Kong	417,691	323,426	444,905	486,895
Special Categories	125,660	175,274	307,326	346,087
Brazil	217,427	299,109	253,572	266,652
Australia	168,937	166,142	178,757	257,342
All other	1,491,136	1,676,878	1,993,602	2,612,102
Total	26,367,926	28,912,820	37,020,200	47,325,993

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-47

SITC division 72—Electrical machinery: EC imports, by leading external sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
United States	6,441,265	6,651,393	6,952,539	8,071,581
Japan	3,651,812	4,216,657	6,117,373	7,914,788
Switzerland	1,343,603	1,438,286	2,196,266	2,937,483
Austria	871,594	986,344	1,460,155	1,964,719
Sweden	759,812	918,330	1,168,249	1,605,167
Taiwan	676,231	660,921	962,280	1,530,356
Korea, South	354,011	408,110	741,596	1,398,071
Hong Kong	529,084	500,744	709,028	1,164,105
Singapore	607,697	556,865	687,848	1,031,061
Malaysia	436,365	534,972	586,418	769,020
Special Categories	88,198	101,151	142,051	540,851
Finland	187,633	216,059	337,590	453,393
Yugoslavia	225,291	230,942	348,462	441,946
Canada	272,015	235,054	287,892	358,475
Norway	130,640	157,784	216,498	265,100
All other	1,346,413	1,407,911	1,803,711	2,406,981
Total	17,921,663	19,221,527	24,717,964	32,853,094

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-48

SITC division 73—Transport equipment: EC imports, by leading external sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
Japan	5,261,070	5,189,940	8,578,501	10,208,080
United States	3,177,735	4,038,795	4,387,560	4,047,537
Sweden	1,566,241	1,653,895	2,735,695	3,157,795
Special Categories	159,488	214,819	278,348	2,828,742
Austria	376,904	400,299	669,720	887,813
Switzerland	225,621	354,277	462,196	642,419
Yugoslavia	227,281	281,611	487,840	567,480
Brazil	238,789	249,248	202,756	490,488
Soviet Union	135,407	155,285	255,166	376,874
Korea, South	39,894	122,881	203,931	316,585
Norway	279,671	159,099	247,162	242,308
Canada	91,376	112,202	147,019	178,725
Poland	152,072	135,005	97,570	168,095
Taiwan	59,810	33,769	52,639	129,305
Finland	63,229	67,344	79,466	123,452
All other	948,793	1,067,174	1,064,985	1,012,704
Total	13,003,378	14,235,645	19,950,548	25,378,401

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.

Table E-49

SITC division 89—Miscellaneous manufactured goods: EC imports, by leading external sources, 1984-87

(In thousands of dollars)

Source	*1984*	*1985*	*1986*	*1987*
Japan	3,258,678	3,342,059	4,600,559	5,557,246
United States	1,994,395	1,992,978	2,430,978	3,102,102
Switzerland	1,029,491	1,058,088	1,525,994	1,983,743
Taiwan	491,555	486,787	765,089	1,348,367
Hong Kong	662,863	636,308	900,569	1,221,071
Austria	523,743	563,945	878,510	1,098,973
Korea, South	235,493	244,036	471,528	984,861
China	152,231	165,140	300,179	668,428
Sweden	245,171	254,993	348,059	430,094
Singapore	193,570	131,444	199,803	274,856
Canada	89,004	63,104	95,669	164,258
Thailand	42,071	49,465	85,261	149,046
Finland	72,602	83,354	116,028	145,826
Israel	49,763	49,518	66,423	102,208
Germany, East	60,278	61,060	81,761	92,705
All other	782,314	761,960	1,058,311	1,329,409
Total	9,883,219	9,944,244	13,924,725	18,653,198

Note.—Because of rounding, figures may not add to the totals shown.

Source: Compiled from official statistics of the United Nations OECD External Trade Database.