1992

CANADA
EUROPE

1992 Implications of a Single European Market

Part I
Effects on Europe

1992

IMPLICATIONS

OF A SINGLE EUROPEAN MARKET

Part I

EFFECTS ON EUROPE

April 1989

The opinions and ideas expressed in this book are those of the author and of the subjects of their surveys and do not necessarily represent the past or current policy of the Government of Canada.

EXECUTIVE SUMMARY

PURPOSE OF THIS REPORT

This report is the first in a series that will examine the implications of the EC Single Market for Canadians.

This particular report, by Business International, deals with the "Effects on Europe." The report consists of two parts. One part outlines the main legislative changes taking place in Europe that will affect the policies of European governments and the framework for doing business in the EC. The other part is based on a survey of 425 executives of large European, North American and Japanese firms active in the EC.

This Executive Summary highlights the main findings contained in the report. It also includes a special section which identifies a number of broad considerations that Canadian businesspersons should consider in defining their future strategies (both offensive and defensive) with respect to the new Europe.

MAIN FINDINGS

A. EFFECTS ON EUROPEAN LEGISLATION

External trade

Although the EC maintains that it will be the most open trading power in the world, even after 1992, repeated EC calls for reciprocity in market access and for preserving the balance of advantages in the GATT have raised concerns to the contrary. However, as yet, there has been no concrete evidence of increased protectionism by the Community in the manufacturing or service industries -- apart from aggressive EC use of the anti-dumping weapon.

One of the EC priorities for 1992 is a common import policy. This will be required to prevent Member States from introducing de facto illegal measures in an attempt to protect sectors no longer shielded by regulations. The Community's various trade-policy instruments -- the safeguard clause, the "new commercial policy instrument" on unfair trade practices, and particularly anti-dumping rules -- will take on much more importance in the future. New target countries and products will be identified, as well as the applications of these rules to the service sector.

There will be an increased focus on local content and rules of origin. It is likely that definitions will be refined in order to define rules of origin as the place where "the most substantial process" rather than where the "last substantial process" occurred.

As 1992 approaches, the six EFTA countries will move as close as possible to EC membership. However, the EC will not entertain any new applications for membership until 1992, and it is unlikely that EFTA will be allowed to develop de facto membership as a bloc.

Foreign investment

Foreign investment will continue to be welcome in Europe, especially operations that make a clear contribution to the economic wealth of the area and include either significant employment or transfer of technology. EC Member States will become stricter and more selective about investment incentives.

By 1992 it is likely that the GATT principle of national treatment will be extended to service companies set up in the EC.

To encourage trans-European companies, the European Commission has started drafting a new text for the European Company statute. The Community is also pushing toward harmonization of various aspects of company law, so that firms compete on equal terms. A key proposal in this area is a directive covering takeover bids.

Intellectual property

In 1989 two major developments could occur with respect to a new framework of intellectual property protection in the EC. These would be the adoption of the European Trademark Regulation and activation of the Community Patent Convention.

The Commission is considering extending the power to impound and destroy counterfeit goods that infringe on trademarks to include copyrights. This would also protect software programs.

Biotechnology is one area where the Community is striving for specific legislation due to the increased reluctance of biotechnology firms to invest in the EC under existing rules.

Product approvals and technical standards

An important part of the Single Market program is the measures that the Community is taking towards mutual recognition of market authorizations in all product areas. To this end, product approval procedures are becoming much more transparent and subject to clear and objective criteria. The goal is to ensure that other European firms benefit from the same treatment as national firms.

Instead of attempting to draft detailed EC-wide standards, the "new approach" to standards and technical regulations now involves the development of broad framework directives limited to essential minimum requirements regarding public health and safety, and environmental or consumer protection. These framework directives are then fleshed out into technical specifications. This is left either to national standards bodies or, where common European standards are necessary, to the Brussels-based CEN (European Committee for Standardization) and CENELEC (European Committee for Electrotechnical Standardization).

The other key element in the new approach is the principle of mutual recognition, i.e. the acceptance by all Member States of products lawfully and fairly manufactured and sold in any other Member State. This principle was developed by the European Court of Justice, notably in the landmark 1979 ruling on "Cassis de Dijon."

The Single Market program also involves the development of European standards in both telecommunications (telecoms) and information technology.

Government procurement

Government procurement contracts in the EC are equivalent to about 15 per cent of Community GDP.

Although liberalization in public procurement has clear political backing within the Community, existing EC directives covering public works and public supply contracts have had little success, to date, in opening up these markets. Therefore in 1988, the Council of Ministers strengthened the rules by increasing the transparency of tendering procedures via longer notification procedures and increased publication requirements. Future EC priority will be given to opening up tendering procedures in telecoms, water, energy and transport.

EC countries will also be moving slowly toward common defence procurement policies through NATO's Independent European Program Group, reinforced by the Single European Act which brings defence into the domain of EC political co-operation.

Technology development programs

Community technology programs are becoming more significant. They not only serve to develop the research or technology itself, but also seek to co-ordinate national R&D (research and development).

There is a multitude of EC research and development programs. The key ones in the industrial sector are ESPRIT for information technology, RACE for telecoms, BRITE for manufacturing technologies and EURAM for advanced materials. These programs fund pre-competitive collaborative research. In contrast, EUREKA is the major program for trans-European development projects.

Finance, banking and insurance services

Liberalization of markets for financial services becomes feasible now that an agreement has been reached on the removal of remaining exchange controls on capital movements.

In banking and financial services the Commission has proposed the introduction of a single licence valid throughout the entire Community via the principle of mutual recognition.

In time, progress in the financial and banking sectors could affect moves towards a European central bank and a common currency. However, this is not part of the 1992 agenda.

In the insurance sector, there will be a clear distinction between regulations governing large corporate customers and those for individuals. For example, with respect to non-life insurance, EC firms will be free to compete across the Community for the business of large corporate clients.

Other legislation

A number of measures under the Single Market program are directly related to environmental concerns. Among these are directives requiring environmental impact assessments for major investment projects, setting timetables for gradual reduction of gaseous emissions from large combustion plants and motor vehicles, and civil liability for environmental damage incorporating the "polluter pays" principle, irrespective of negligence.

Other significant policy changes that are dealt with in the report, but not included in this summary, are changes in the areas of competition policy, state aids, regional development, labour legislation and taxation.

B. EFFECTS ON EUROPEAN FIRMS

The observations in this section are based on a special survey of 425 manufacturing and service firms active in the EC. The sample consisted of 123 EC-based firms, 56 EFTA-based firms, 164 North American-based firms and 14 Japanese firms.

Structural changes

The Single Market program will quicken the pace and shape the direction of the structural changes already under way in European industry. These include:

- o increased concentration of industry structures;
- o acceleration of national and cross-border mergers and acquisitions;
- o proliferation of cross-border alliances in R&D, production and marketing;
- o focus on core businesses; and
- o rationalization of production facilities on a European scale.

One factor behind this prospective shakeout is the fact that in many sectors, Europe's fragmented markets now support many more firms that can co-exist comfortably in the post-1992 competitive arena. For example, there are 13 locomotive builders in Europe compared with 2 in the U.S. and 3 or 4 in Japan. Similarly, Europe has about 40 suppliers of car batteries versus 4 in the U.S. and 11 manufacturers of public telephone exchanges compared with 4 in North America. In a few sectors, such as automobiles, where there are already 6 major European groups, the overcrowding is getting worse as Japanese competitors add capacity in Europe.

In the survey of executives in Europe which was conducted for the present study, about 85 per cent of all manufacturing and service firms indicated that the 1992 program would encourage a moderate or strong shakeout of competitors in their sector. The competitive shakeout is most strongly expected in food, mechanical engineering and pharmaceuticals, with the lowest scoring in the automotive sector.

Most executives surveyed expect that the restructuring that takes place in their sector will consist of rationalization to achieve cost-cutting. However, the impact for sectors such as telecommunications is expected to be more specialized production.

The forces behind restructuring will vary from sector to sector, depending on the industry's characteristics. For example:

- o Producers of commodity products, such as basic chemicals, pulp and paper, metals and minerals and energy, are capital-intensive and compete on the basis of low-cost production and an ability to consistently provide good standard quality output. The Single Market will mean that some firms will have to expand production while others concentrate on specific product lines.

- o Producers of branded consumer products, such as cars and food products, rely on a strong marketing strategy, with heavy investment in international advertising to support local distribution and service. More international alliances or major takeovers are expected, as are strategies to buy market share, build international brands and establish large automated production facilities.

- o Custom manufacturers (auto parts, specialized machinery and equipment) require close R&D co-operation with their clientele, often close physical proximity, as well as high quality and servicing. Mergers and collaborative agreements of all kinds (including arrangements with local universities and research centres) will be pursued, especially in high-tech fields.

- Wholesale and retail distribution is dependent on appropriate locations and knowledge of consumer demand, and as such, still regionally oriented. Although there are questions about the logic of cross-border concentration, there are an increasing number of successful examples. Expansion is a means of increasing buying power, leading to bigger discounts and higher profitability.

- In the financial services area, increasing competition between banks and near banks (including insurance companies) coupled with growing integration of capital markets will produce major changes. Some niche players and some major groups will finally survive. The changes, however, will be slow.

- In high-technology industries (i.e. research intensive and technology based) the driving force behind concentration is the search for critical mass to support escalating R&D costs. This implies the need for the broadest possible market base -- certainly one larger than that provided by Europe's individual national markets. Since many high-tech sectors -- telecommunications, power generation and defence electronics -- have been dominated to date by national champions insulated from competition, massive restructuring is inevitable and indeed already under way.

Mergers and acquisitions/corporate alliances

The restructuring process will often take the form of mergers and acquisitions, joint ventures and other forms of corporate alliances. Survey results show that 30 per cent of the manufacturing firms and 56 per cent of the service companies predicted that increased merger and acquisition activity would take place in their sectors as a result of the 1992 program. The percentages were even higher when firms were asked about their own company plans.

Of the three basic acquisition strategies -- horizontal, vertical or diversification -- firms surveyed overwhelmingly favoured the first strategy. Vertical integration strategies are relatively uncommon except in telecoms, metals and chemicals. Diversification goals were found to be significant for auto firms, chemical companies and building material suppliers. In financial and business services, no one merger and acquisition goal prevailed.

A striking feature of the survey results is the overwhelming predominance of cross-border (intra-European) merger and acquisition plans over purely national deals.

The advent of the Single Market has also triggered an explosion of cross-border corporate alliances. The survey results show that interest in alliances is as great as for mergers and acquisitions and is even greater in the auto sector and Electronic Data Processing (EDP). These alliances can take a number of forms, from equity joint ventures or cross-shareholdings to contractual relationships. The co-operation may range from R&D and equipment sourcing to joint production and cross-marketing.

Research and technology management

The role of R&D as a competitive factor was stressed frequently in the survey by large and small firms alike. Nearly 40 per cent of manufacturers indicated that they planned to increase R&D spending as a percentage of sales, and nearly 50 per cent cited the need to reduce product development times. Mechanical engineering firms put the greatest stress on both these objectives, while several other sectors such as autos, electrical/electronics, EDP, pharmaceuticals and telecoms, put high emphasis on faster product innovation.

High-technology firms in the EC stress the importance of spreading R&D costs over a broader market base. The lack of such a base is cited as a key competitive handicap against U.S. and Japanese rivals.

R&D collaboration is seen by many as a way to achieve critical mass in the research function. Over 40 per cent of the EC and EFTA firms surveyed expect to participate in joint R&D projects under EUREKA, ESPRIT, RACE, etc.

The survey also indicated that the proportion of firms planning to emphasize licensing or buying technology was nearly as great as for those planning to increase R&D spending. In fact in a number of sectors it was higher, particularly in the building materials and pharmaceutical sectors.

Investment strategies

Investment strategies in the EC vary significantly among the different types of firms surveyed.

For example, while almost half of EC-based firms indicated they would focus their investments in other EC markets, more than half planned also to expand investments in North America and offshore markets.

EFTA-based firms are building up their presence within the Community. They give relatively high ratings in their investment plans to local production in the EC, and to acquisitions and alliances with EC firms. They also are building capacity at home to increase exports to the EC.

For U.S.-based multinational firms, 1992 has given Europe a higher priority in their investment plans. The result is that direct investment by U.S. multinationals in Europe is growing again, mainly through reinvested profits.

Japanese and Korean companies, faced with ongoing barriers against their exports, have concluded that the only way to secure access to the post-1992 EC market is through investment in the EC. Japanese direct investment in the first half of 1988/89 was up 25 per cent from a year earlier.

Marketing strategies

Whatever their nationality or sector, manufacturers responding to the survey cited marketing and distribution as the aspects of business that will be most affected by the Single Market program. For service companies, marketing again topped the list.

A fundamental issue is the extent to which the Single Market will smooth out national differences within Europe. Looking at the implications of 1992 in terms of market changes in their sector, some executives expect a strong trend towards the emergence of a homogeneous "Euro-consumer." The homogenizers are especially dominant in energy, metals, autos, electrical/electronics and insurance. However, others give greater weight to continuing differentiation between national markets. The expectation of continued differentiation prevails strongly in building materials, distribution, EDP, banking and consumer goods.

Segmentation is the key to the marketing strategy of the majority of manufacturing and service firms surveyed. The general trend is to focus on market niches -- most often at the pan-European rather than national level -- although the latter prevails in construction and financial services.

There are mixed views on the extent to which national wholesalers and retailers will be extending their operations across the EC market. The small sample of distribution firms surveyed was split evenly between those aiming at pan-European and those focusing on national market niches.

The Single Market will create strong pressure for co-ordinating of marketing and the streamlining of physical distribution. More than half the manufacturing firms surveyed planned to tighten control of marketing and service operations, with the strongest emphasis in the autos, EDP and metals sectors.

Logistics is another area that will undergo major changes as a result of 1992. A third of all industrial companies surveyed indicated that they planned to centralize physical distribution, with the highest response coming from metals and minerals firms. A major focus of attention is deciding where to centralize production and warehouse locations.

The objectives of efforts to overhaul distribution systems, whether through computerization or centralized warehousing, are to reduce costs and speed up deliveries. Overall, 38 per cent of the manufacturing firms surveyed planned to use computer networks to track selling patterns; 43 per cent aimed to reduce inventories in the distribution system; and 64 per cent hoped to reduce delivery times and improve responsiveness to customers.

Import and export patterns

Sixty-nine per cent of manufacturers surveyed predicted that the 1992 program would have a moderate-to-strong impact on the growth of intra-EC trade. Growth in intra-EC trade is generally expected to be stronger than competition from non-EC imports, but in three sectors (automotive, electrical/electronics and metals), the increases in EC and non-EC imports are rated equally.

On the export side, nearly two-thirds of EC companies stressed increased sales to other EC markets, while one-third emphasized exports to the rest of the world.

With respect to purchasing patterns, 36 per cent of the manufacturing firms surveyed indicated that their own companies would put a strong emphasis on sourcing from other EC countries. Mechanical engineering stands out with a 68 per cent rating while telecoms are at the other extreme with a surprisingly low 9 per cent.

The survey reveals a keen interest in reducing in-factory inventory holdings, for example through just-in-time inventory management, especially in the mechanical engineering, machinery, EDP and auto sectors.

Many executives stressed that their companies would maintain an even-handed procurement policy, as between EC and non-EC sources, motivated by strictly commercial or strategic considerations. However, several executives expressed concern over EC policies, such as EC anti-dumping pressures, that could restrict their ability to buy abroad.

A fundamental aim of the 1992 program is to develop European industries that can face their U.S./Japanese rivals in global competition. The survey supported the impression that EC firms will remain outward looking. Indeed, one of the most striking results of the survey is the high proportion of companies that see Europe simply as part of a global strategy -- over 60 per cent overall in both manufacturing and services, and over 80 per cent in EDP, mechanical engineering and telecoms.

Costs and competitiveness

Discussion of potential costs savings stemming from the Single Market usually starts with the removal of frontier controls. Commission studies estimate that the cost to firms of customs compliance in intra-EC trade amounts on average to 1.5 per cent of the value of shipments. Although relatively small, these costs may be a major consideration where profit margins are low. Moreover, border delays and uncertainties are becoming increasingly problematical as just-in-time management of components supply gains in importance. Wholesale and retail distributors are understandably the most interested in this aspect of the internal market agenda.

For manufacturers, significant cost savings are expected to come from restructuring and lower input costs.

- Rationalization: To ensure healthy long-term profits, companies will be taking steps to concentrate and specialize production in different plants, close down some facilities, and stream-line their product range. Sectors that expect significant savings from rationalization include metals, machinery, building materials, food and mechanical engineering.

- Economies of Scale: These are the prime considerations for auto firms, and electronics, food and telecoms companies.

- Access to Cheaper Inputs: This is of particular interest to mechanical engineering and machinery firms.

- Lower Financing Costs: Lower financing costs are the principal concern for construction firms, but of general interest to all sectors. Many executives expect to benefit from the liberalization of banking services.

IMPLICATIONS FOR CANADIAN BUSINESS

Strategic considerations

Despite the occasional setback the Single Market program remains on track. Over 40 per cent of the legislation has already been passed. Canadian business should make the working assumption that the 1992 deadline will be met.

The scope of the process of deregulation and reregulation in the EC is so extensive that most Canadian firms will have to seriously reassess their strategies in Europe. The impact of the Single Market will not be confined to the 12 Member States of the EC. The six countries of EFTA are already taking steps to bring some of their legislation in line with that of the EC.

Market access

The rules of access for exporters and foreign firms to the Single EC market are not yet clear. However, it is significant that in most sectors, the EC-based firms surveyed felt that the primary impact of the 1992 program will lead to an increase in non-EC competition rather than lead to higher EC barriers. The sectoral exceptions were autos, steel and telecoms.

It is also important to recognize that the Uruguay Round of multilateral trade negotiations (MTN) will have a significant effect on the evolution of the Single Market. The GATT constitutes a constraint on the shape of the EC's internal market by imposing compliance with international obligations already set out in the General Agreement. The Uruguay Round offers an additional opportunity for third countries to influence the shape of 1992 through bilateral negotiations with the Community within the MTN context and through improved disciplines in such areas as the GATT code on technical standards, market access negotiations on rules of origin and government procurement.

Since the MTN is expected to finish before 1992, results achieved in the "new issues" of services, intellectual property and trade-related investment measures are also likely to affect the final shape of Community arrangements.

Sourcing decisions

As a result of the restructuring now under way, corporate customers in the post-1992 EC are expected to be fewer and bigger. Canadian firms will have to deal with larger EC firms. This includes small firms becoming medium ones.

EC firms plan to adjust their purchasing policies by rationalizing supplier networks and by concentrating orders to maximize buying power. However, few companies are prepared to go so far as to rely on single-source suppliers.

The increased emphasis on just-in-time production in the EC will lead to new supplier relationships based on close proximity, good communications and compatible information systems (hardware and software). Similarly, the growing sophistication of production techniques, with computer-integrated systems solutions requiring close co-operation with the customer, will encourage a greater regionalization of suppliers.

When it comes to purchasing technology, the overriding concern for EC firms is to get the best technology irrespective of nationality. EC firms show a strong tendency to look outside Europe and especially to North America for potential technology licensors.

Government procurement

Access by Canadian exporters to the liberalized EC government procurement markets will be governed by existing GATT rules and any new agreements negotiated during the Uruguay Round.

However, for Canadian firms producing in the EC where procurement offers are equivalent, Community preference could be invoked to exclude bids with less than 50 per cent EC content.

Investment considerations

Non-EC firms, whether from EFTA, North America or Japan, will be putting their emphasis on investing in production facilities within the Single Market rather than supplying it through exports.

Initially, investments generated by the Single Market will gravitate towards those countries and regions with the best infrastructure and skilled workforces. Manufacturing firms have identified France, Germany, Italy, the U.K. and Spain as their preferred locations for production and export to other EC markets. The pattern holds, too, for firms in the service sector, except that the U.K. and West Germany enjoy a clear lead in preference.

Marketing and distribution

For manufacturing firms, pan-European distribution networks will be a key competitive weapon in the post-1992 era, as barriers and costs of transborder shipping come down.

It is also anticipated that there will be fewer distribution levels since in many cases there will be no need for national distributors.

Many EC firms will be centralizing their physical distribution. In particular, major centres in the Netherlands rate highly in the plans of EC firms. The Netherlands is a strong choice for distribution centres because of its central location, major sea ports and airports, and strong trucking industry.

Technical barriers

EC manufacturing firms surveyed for this report rated the removal of technical barriers to intra-EC trade and the creation of common EC standards as the two most positive impacts of the 1992 program. However, only one-third expect progress on this front to have been achieved by 1992; most expect significant results no earlier than 1995.

Foreign suppliers, protected by the GATT principle of national treatment, should benefit from the new product approval procedures that are being put in place under the Single Market program.

For non-EC suppliers, mutual recognition implies that a company can make its product conform to the norms of the Member State that suit it best, and then channel all its exports to the EC through that State. This would seem to be an improvement on the present situation whereby authorization must be obtained from each Member State in which the exporter chooses to sell.

Although outside suppliers will be given the same access to national certification procedures as local firms, the EC has signalled that it will only recognize tests and certificates issued by third countries if mutual recognition has been negotiated by Brussels (and not by individual Member States).

Technology programs

In theory, non-EC owned firms operating in the Community will be welcome to participate in all Community R&D programs as long as they have something special to offer and their research is carried out in laboratories within the EC.

Services

The liberalization of financial services and the free movement of capital are rated highly by firms in the service area (especially banking and finance) as well as manufacturing firms as two very important benefits of the Single Market program.

The free movement of personnel is of top importance to business services -- a group that includes accountants, law firms and engineering consultants -- whose staff will benefit after 1992 from the mutual recognition of professional qualifications.

Although there should be no legal barriers to non-European service firms that are located in the EC, a de facto preference for European companies will make it a definite asset to seem as "European" as possible.

Increased competition from European firms

Almost 60 per cent of EC manufacturing firms surveyed and 45 per cent of service companies felt that the 1992 program would have a moderate-to-strong effect in terms of strengthening EC firms as competitors in third markets.

FOREWORD

The Department of External Affairs is pleased to present the first part of a study on the Implications of a Single European Market. This report, *The Effects on Europe*, details the major economic and trade effects of the integration. It also provides a clear picture on the situation, the general expectations, and the responses by European governments and industries to the unification legislation and implementation measures.

For the first part of the study, Business International, the consulting arm of *The Economist*, surveyed 425 executives of major European and non-European companies for their views on the Single Market and its effects on their industry and on their own corporate strategy.

The second part of this study on the Implications of the Single European Market will analyze the effects of 1992 on Canada's trading, investment, and technology interests in specific sectors. It will be released by sector from the fall of 1989 to early 1990. A third part will examine the response of other non-Community countries to the Single Market.

The creation of a Single Market of 325 million people will offer Canada new business prospects. To take advantage of these opportunities, the time to prepare is now.

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List of Charts and Tables

LIST OF ACRONYMS AND ABBREVIATIONS

AG	Stock Corporation (traditional organization for larger businesses in Germany)
CP	Common Position
CPC	Community Patent Convention
EC	European Community
ECU	European Currency Unit (= $1.33 Cdn: March 1989)
EDP	Electronic Data Processing
EEIG	European Economic Interest Grouping
EFTA	European Free Trade Association (Austria, Finland, Iceland, Norway, Sweden and Switzerland)
EP	European Parliament
GDP	Gross Domestic Product
HDTV	High-Definition Television
IM	Internal Market
IMP	Implementation
IPP	Intellectual Property Protection
IT	Information Technologies
JIT	Just-in-time (Refers to Inventory Management)
JV	Joint Venture
M&A	Mergers and Acquisitions
MNC	Multinational Corporation
NIC	Newly Industrialized Country
NIE	Newly Industrialized Economy
NIPC	New Commercial Policy Instrument
OEM	Original Equipment Manufacturer
PTT	Post, Telephone and Telegraph (Government Agencies)
QR	Quantitative Restriction
R&D	Research and Development
SAD	Single Administrative Document
SEA	Single European Act
TELECOMS	Telecommunications
VAT	Value-Added Tax
VDT	Video Display Terminal

NOTE: All dollar figures in this report are in U.S. dollars

INTRODUCTION

The European Community has embarked on a long process toward the complete liberalization of its internal market. By 1992, it is expected that most, if not all, internal barriers to the free movement of goods, people, capital and services among the 12 Member States of the Community will be eliminated. The driving force behind this ambitious project is a shared European goal of global competitive strength for European industry, by taking advantage of a single unified market of 325 million consumers.

The idea of a Single Market is not new in the Community. The 1957 Treaty of Rome, which established the European Community, provided the legal basis for all the measures proposed in the 1985 White Paper on Completing the Internal Market. The White Paper proposed about 300 measures that would need to be passed in order to achieve the complete liberalization of the internal European market. In 1986, the European Single Act was passed by Member States in the European Parliament. This gave the European Commission the authority to implement the pieces of legislation which would ultimately lead to the creation of the Single Market by 1992.

For Canada, this development presents major opportunities and challenges. If they meet the 1992 target date, the 12 members of the EC will create the largest trading unit in the world with a GDP equal to that of the United States. The EC accounts for one-fifth of global trade. The EC ranks as Canada's second largest export market. It is our most important overseas source of foreign investment, R&D and tourism. Any change in Europe's trading rules will have an impact on Canada -- not only on Canadian exports to Europe and to third countries, but also, as European competition sharpens, in Canada's domestic market.

Clearly, it is important that Canadians must begin to prepare now for 1992 in order to respond to the challenges, to take advantage of the opportunities and to adapt to change.

The Government of Canada is in the process of assessing what the Single Market means for Canada and its economy. To this end, the Canadian government has developed a comprehensive strategy called "1992 Challenge."

This program has three objectives:

- o The first is to develop an accurate assessment of the implications of the Single Market for Canada.

Working groups have already been set up to look at how the Single Market legislation could affect Canadian industrial sectors. An ongoing dialogue has been established with the provinces and the business sector to identify and analyze the likely impacts of the European Single Market on the economy.

- o The second objective is to facilitate the awareness of the opportunities and challenges flowing from the completion of the Single Market.

This study is the first in a series aimed at helping Canadian firms assess the implications of 1992.

- o The third element is to develop an appropriate and effective response to capitalize on the 1992 opportunities.

The Canadian government's response to 1992 will largely be built on a comprehensive framework of trade and investment promotional activities, and science and technology co-operation initiatives aimed at supporting the business community in its efforts to capitalize on 1992 opportunities. The program will include sectorally focused trade promotion, joint ventures and technology-transfer activities, investment development and training programs for new exporters to the EC.

A. EFFECTS ON EUROPEAN COMPANIES

A.1 STRUCTURAL CHANGES

The approach of the Single Market in the 1990s is only one factor behind ongoing structural changes in European product and service industries. Companies in Europe must also cope with a series of other changes in the European and world economies -- the spread of global competition in many sectors, drastic shifts in real exchange rates vis-à-vis the U.S. and Japan, the challenge from the newly industrialized countries, deregulation, new environmental controls requiring modifications in products and technologies, changes in European markets and accelerating technological innovation.

But the 1992 Single Market program will quicken the pace and shape the direction of the structural changes already under way in European industry, such as:

- increasing concentration of industry structures;
- accelerating mergers and acquisition (M&A) activity (national and cross-border);
- proliferation of cross-border alliances in research and development (R&D), production and marketing;
- moves up-market to higher value-added products and activities;
- refocusing on core businesses and shedding of peripheral ones;
- quest for leading market shares (in markets that are themselves being redefined in pan-European or global terms);
- rationalization of production facilities on a European scale;
- cost-cutting efforts towards productivity raising and quality improvement efforts;
- faster product innovation and shorter life cycles; and
- introduction of automation and information technologies.

The trend toward massive reductions of industrial employment during the early 1980s has been halted, if not reversed, by the general economic recovery in the past two years. But fears are that 1992-related restructuring could lead to a new wave of labour shedding. Even the European Community Commission's generally upbeat Cecchini Report estimates that up to 500 000 jobs could be lost before the Single Market starts creating net employment. Hence the Commission's urgent calls for a "social dimension" to the 1992 program to head off a backlash from the unions and public opinion.

Meanwhile industry also seems to have woken up to the major challenges awaiting companies if the 1992 objective is fulfilled. Leading industrialists such as the U.K.'s Sir John Harvey-Jones warn that half the companies in Europe could disappear in the transition to the Single Market.

One factor behind this prospective shakeout is that, in sector after sector, Europe's fragmented markets now support many more companies than can coexist comfortably in the post-1992 competitive arena. Thus Sweden's Percy Barnevik (chairman of the newly merged electrical giant Asea Brown Boveri) points out that there are currently 13 locomotive builders in Europe, and the number will have to be reduced if Europe is going to compete with two in the U.S. and three to four in Japan. Similarly, Europe has 40-odd suppliers of car batteries, versus four in the U.S.; 11 manufacturers of public telephone exchanges, versus four in North America; and so on.

In a few sectors, overcrowding is getting worse as more foreign competitors pile into Europe with new capacities. A prime example is the auto industry, where Europe already has six big-volume car producers, plus Nissan building up production in the U.K. and Toyota on the horizon.

More often, however, non-EC entrants favour the acquisition route as a way of building a solid base in the Single Market without adding to existing capacity. EFTA firms usually adopt this strategy -- examples are ABB in power and railway equipment, Electrolux in appliances, Nokia in TV sets. Indeed, this approach may help to resolve existing structural problems by consolidating weak EC producers into bigger and stronger (though foreign-owned) competitors.

Size

The most detailed and up-to-date survey of industrial structures in the Community is provided by the Commission's recently published *Panorama of EC Industry 1989*, an assembly of monographs covering over 125 product and service sectors. The introductory overview offers this observation on the progressive concentration of EC production into larger units:

> "Among the structural changes ... reported for most sectors -- services and manufactures alike -- is an apparent increase in concentration ratios. This seems to lead to a camel- rather than bell-shaped curve of distribution of turnover between few very large firms, a declining proportion of medium-sized, and a large number of small, increasingly specialized firms. At the same time, even small firms are getting larger (90 rather than 10 employees), as sophisticated and more capital-intensive technology is introduced into 'cottage' industries, from brick making to paper bags or thermoplastics; and from transport to software."

In a mail survey of over 400 executives in Europe which was carried out for the present study (summarized in Appendix II), about 50 per cent of all industrial and service firms indicated that the 1992 program would strongly encourage a shakeout of weaker competitors in their sector. A further 35 per cent felt this impact would be moderate, and only 13 per cent thought it would be negligible -- the lowest such rating for any of the factors considered. As can be seen from Chart A1.1, the competitive shakeout is most strongly expected in food, mechanical engineering and pharmaceuticals, with the lowest scoring in the automotive sector.

CHART A1.1

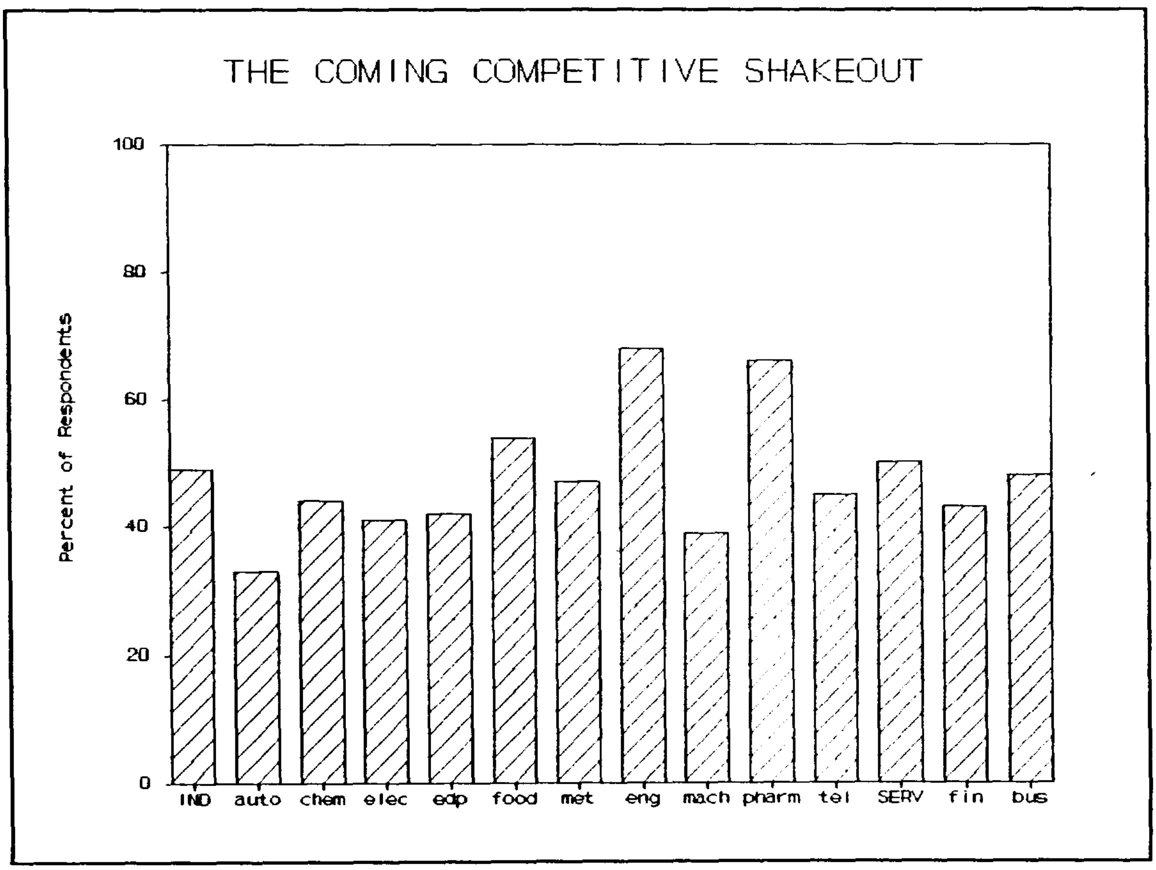
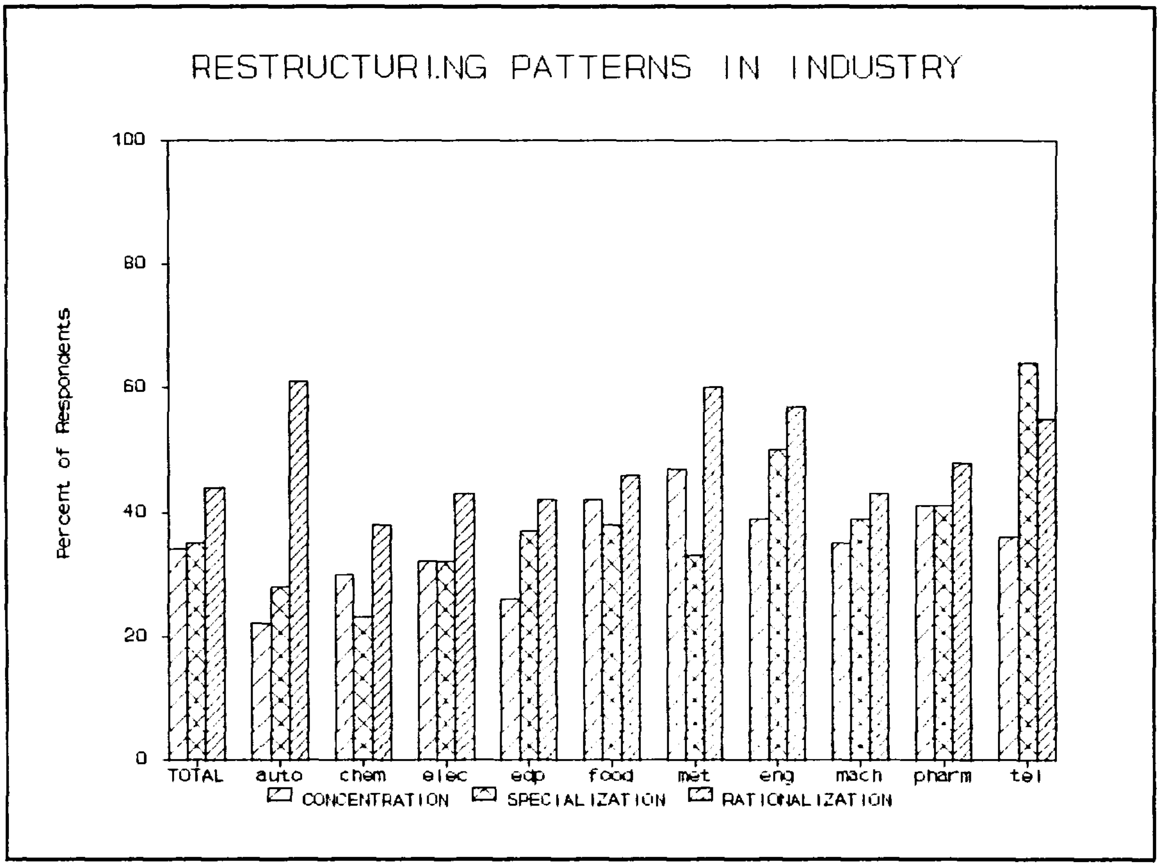


Chart A1.2 examines some of the restructuring patterns in industry: concentration of production, more specialization, and rationalization or cost-cutting. Rationalization is the predominant effect expected in most sectors (except telecommunications, where specialization comes higher). Again the auto industry (including auto parts) sees least scope for concentration, but expects the highest rationalization impact of any sector.

CHART A1.2



In Europe as in North America, the major theme of corporate restructuring among large companies is to concentrate efforts and resources on businesses in which they can be European or world leaders, while withdrawing from fields where they lack this potential. This puts a premium on market share, which often entails large size, especially in markets now perceived as regional or global. Some examples:

- Nestlé, the Swiss food giant, strives to build global brands for markets segmented on a transnational basis (e.g., single households, the health conscious). Once markets are identified in this way, says chief executive Helmut Maucher, Nestlé's aim is to be the number one producer, worldwide.

- The Italian appliance maker Merloni, with its Ariston brand, now ranks number three worldwide behind Electrolux and Whirlpool. President Vittorio Merloni is convinced that the approaching unified market will translate into the survival of the fittest -- and the biggest. In his view the number of players in the world appliances industry will shrink to "no more than five" by 1992.

  Merloni's rule of thumb to guarantee a competitive position in any market is based on achieving "at least a third of your largest competitor's market share." Its first major step toward this critical mass target was the 1987 absorption of ailing Indesit. Further acquisitions are likely, and ultimately Merloni would like to join forces with one of the major players left in the field, possibly German or U.S. In this way it hopes to be one of the survivors beyond 1992.

- Says the European director of a major U.S. telecoms group: "There's a number that's often thrown around, if one doesn't get 8 per cent of the world switching market, you can't hope to have enough to spend on R&D to keep ahead of the rest of the pack. Given that not everyone has a nice even 8 per cent -- some have 15 to 16 per cent -- it's clear that there isn't enough room for all the existing players....

  "But having said that, I don't adopt the theory that we'll go down to three or four or something, because there are some new players coming on the scene." Thus the Indian, U.S.S.R. and Chinese industries, though initially serving their huge protected home markets, "in the long term those companies will also be part of the whole picture. So I think that for as many as get knocked off through mergers and acquisitions, there'll be these others coming along."

Many of Europe's smaller companies are also pursuing market share strategies, on a scale appropriate to their more modest means. An example is an Italian family-owned chemical firm; with annual sales of just $40 million, it is nonetheless Italy's number one producer of certain specialty chemicals used in the animal feed industry. In the view of its chief executive, the Single Market will mean more mergers and rationalization among the major chemical firms: "I can see further concentration of the industry going on ad infinitum." This leaves the smaller players with three choices -- disappear, be bought out, or develop niche markets of their own.

As this entrepreneur has strong feelings about maintaining his independence, he is pushing the company toward niche markets. For example, it hopes to become the strongest producer/distributor of paint solvents, a sector that is highly fragmented with 400-odd producers across Europe competing for business.

"We are going to simply become a different company to survive in the new market," he announces. "We need to find a space for ourselves and use what we have -- for example, we think we have a decent distribution network." Thus the renewed company will pare down its production facilities and concentrate more on importing and distributing products manufactured elsewhere in the EC. It will also try to build up a business in "very simple formulation contracts for products we will later sell on our markets." The new strategy reflects a conviction that "Medium-sized chemical companies like ours just simply don't have the financial muscle to bankroll the kind of R&D and investments you need today to keep up with the big guys."

In a country such as Portugal, the urgency of restructuring for 1992 is understood; the question is whether local industry can possibly make the grade in time. Productivity is less than a third of the European average, and more than two thirds of all companies are family concerns with less than 10 workers; only 0.5 per cent employ over 500 people. Output is dominated by a few traditional sectors -- textiles, shoes, paper pulp, ceramics, furniture and food processing -- that represent around 65 per cent of industrial exports.

"The mortality rate among small companies is going to be high after 1992," said one official. "Many of those producing for the home market will find it simply impossible to compete with imports." Brussels is bankrolling a special aid program (Pedip) to help as much of Portuguese industry as possible survive exposure to the full brunt of EC competition. But the bulk of Pedip funds is earmarked for reconverting Portugal's traditional sectors, and medium-sized companies are likely to benefit the most. In certain sectors, even generous restructuring funds are unlikely to keep plenty of companies from going to the wall.

By contrast, many of the export oriented, small- to medium-sized companies that represent such a major force in German or Italian industry stand to benefit from the Single Market. In the case of Italy, a recent survey by Censis reveals the following pattern:

- 24 per cent of the companies surveyed, largely manufacturing industrial components and employing 100 to 200 workers, already draw a growing proportion of their sales from exports and have forged commercial or technical links with foreign partners.

- A smaller group of 4 per cent, largely mechanical engineering firms with over 200 employees, are more deeply involved in international business, deriving up to 75 per cent of their sales from abroad and with direct investments, joint ventures or technology sales outside Italy.

- A further 13 per cent, mostly in southern Italy, are offshore production centres for foreign companies manufacturing furniture, leather and wood products.

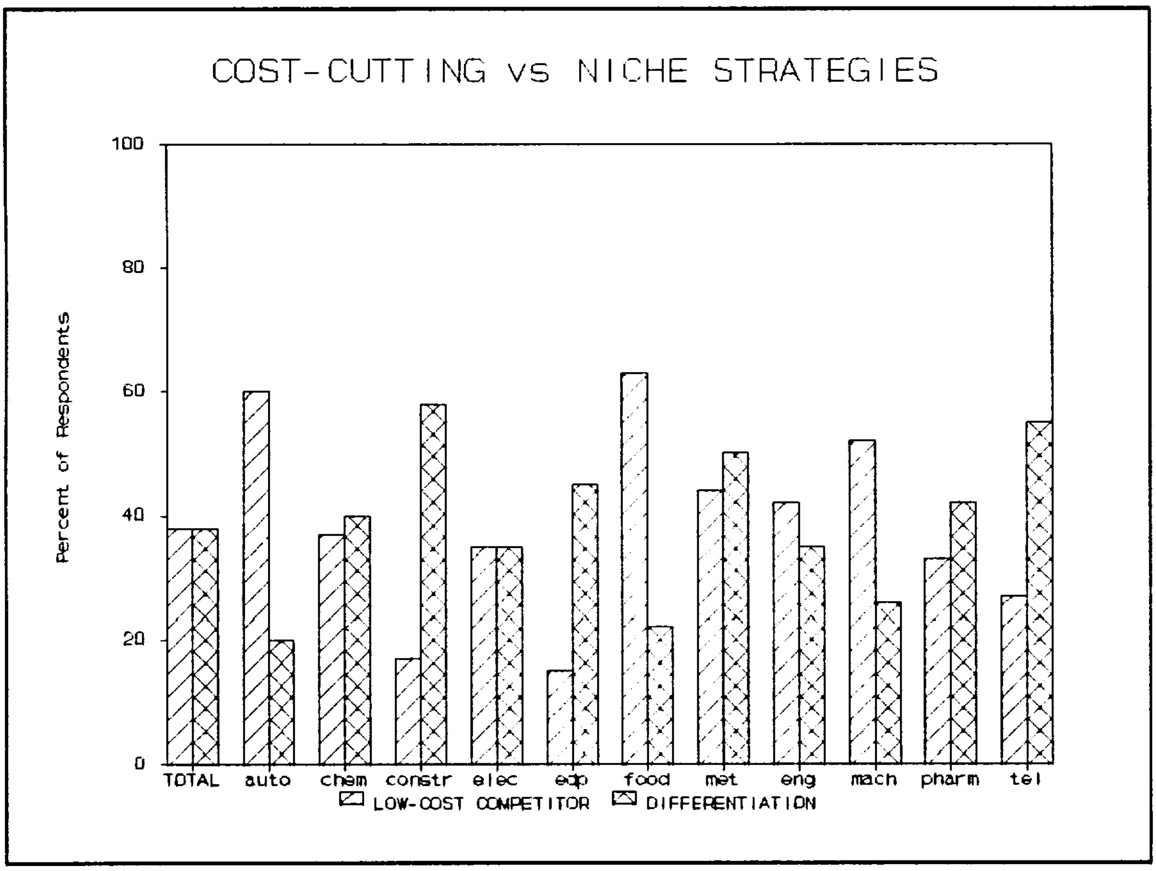
- The remaining 59 per cent are exporters of traditional consumer goods (textiles, clothing and shoes, furniture) which sell abroad only through wholesalers and distribution chains.

While the first two groups are expected to hold their own in the Single Market, the outlook for the last two is less positive. Export volumes in these traditional sectors tend to be static, with severe price competition from lower-cost Third World producers.

Size often dictates competitive strategy. In the business impact survey, essentially covering large EC and non-EC multinationals, there was an even split between companies that plan to emphasize cost reduction (becoming a low-cost competitor) and those preferring to concentrate on product differentiation. American companies tend to favour the low-cost strategy, while European (especially EFTA) firms prefer to seek out differentiated niches. Service firms also lean toward the latter option.

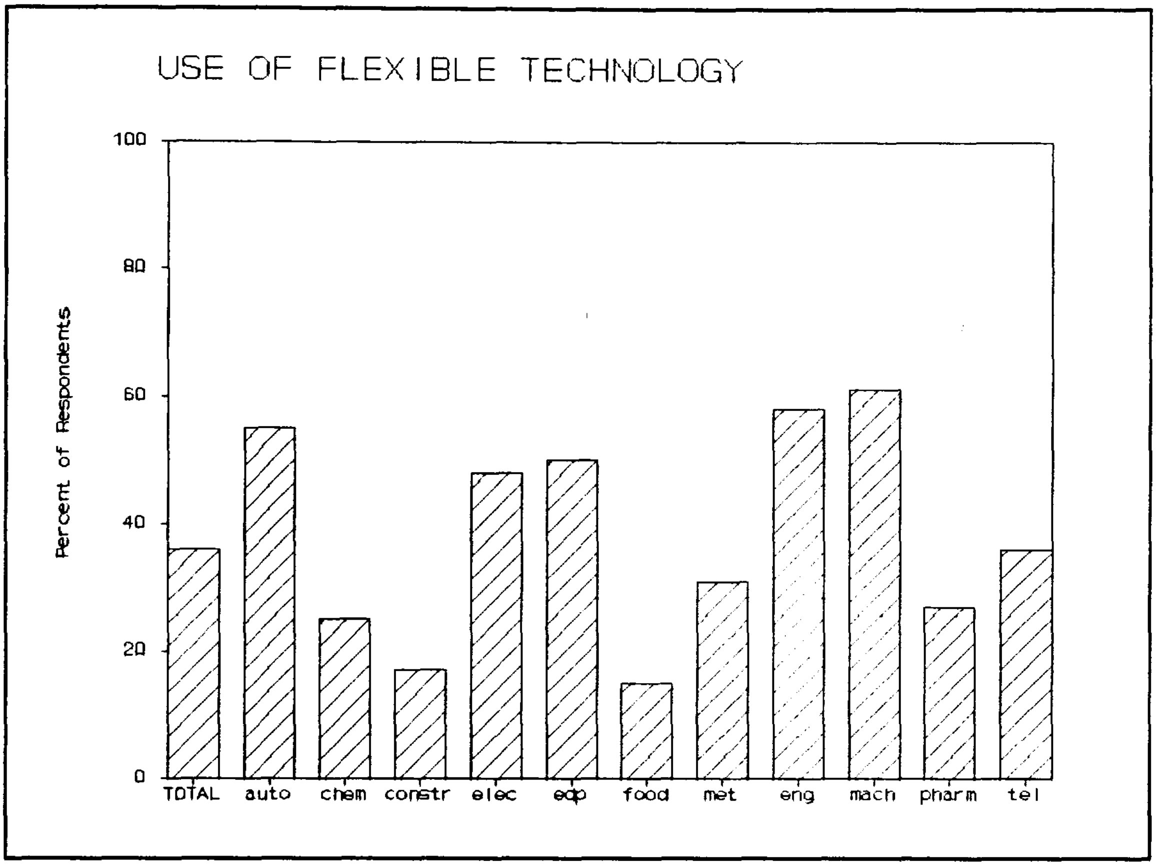
As Chart A1.3 reveals, the cost leadership approach is strongly favoured in the automotive, food and machinery sectors, while niche strategies predominate in construction and building materials, data processing, pharmaceuticals and telecoms.

CHART A1.3



But competitiveness is not always dependent on size. The current wave of restructuring in Europe coincides with an unusually rapid change in manufacturing methods and product technologies, which is profoundly affecting the economics of many industries. In particular, the implementation of flexible manufacturing techniques (see Chart A1.4) is altering both economies of scale and entry barriers. Giant companies may no longer enjoy a competitive edge, except in capital-intensive sectors such as aerospace.

CHART A1.4



Indeed, the advantage of U.S. multinationals well established in Europe over their "national champion" competitors is not so much a question of size as of geographic spread. In many industries, scale economies today are derived principally from the ability of a large firm to co-ordinate production among dispersed units to meet diverse local market demands, rather than from mammoth plants producing standardized products.

Structure

The forces behind restructuring will vary from sector to sector, depending on the industry's characteristics. A German banker (Dr. Wolfgang Rupf of BHF-Bank) offers the following categorization:

° *manufacturers of commodity products*
(e.g., basic chemicals, pulp/paper, metals/minerals, energy)

These are capital-intensive sectors, dependent upon low-cost production and the ability to provide good standard quality. Plant locations may be governed by access to raw materials or cheap energy, but good international logistics and distribution in major European and international markets is a must. Many firms already meet these tests, but some must either expand further or concentrate on specific product lines.

° *manufacturers of branded goods for broad consumer markets*
(e.g., cars, food products)

These rely on a strong marketing strategy, with heavy investment in international advertising to support local distribution and service. Expect more international alliances or major takeovers (Nestlé/Rowntree), efforts to build international brands, large automated production facilities.

° *manufacturers of more customer-designed products*

(e.g., auto parts, machinery and equipment)

These require close R&D co-operation with clientele, high quality and servicing. Presence close to the customer is a must, as is international management and a creative skilled labour force prepared to work with clients. Mergers and collaborative agreements of all kinds (including with local universities and research centres) will be pursued, especially in hi-tech fields.

° *wholesale and retail distribution*

Dependent on appropriate locations and knowledge of consumer demand, these are still regionally oriented. Many question the logic of cross-border concentration, although there are some examples (e.g., French hypermarket chains moving into Spain, German mail-order firms into France). However, expansion is a means of increasing buying power, leading to bigger discounts and higher profitability.

° *financial services*

Increasing competition between banks and near-banks (including insurance companies), coupled with growing integration of capital markets, will produce major changes in the coming decades. But, says Rupf, "bankers are very cautious people, they go forward very slowly," and the lack of internationally oriented top management will retard cross-border adventures in this field.

With the advent of the Single EC Market, pressure for restructuring and concentration will be greatest in those industries that combine two characteristics: high technology and protected home markets.

In "hi-tech" (i.e., research-intensive and technology-based) industries, the driving force behind concentration is the search for critical mass to support escalating R&D costs. Moreover, shortening product life cycles create pressure to maximize income from new products as quickly as possible. All this implies the need for the broadest possible market base (hence globalization) -- certainly broader than that provided by any of Europe's individual national markets.

But many hi-tech sectors have thus far been compartmentalized in Europe, with protected national champions that face little international or intra-EC competition. Prime examples are telecommunications, power generation, defence electronics -- significantly, all dependent to some degree on public-sector buyers. In consumer electronics, personal computers etc., markets are generally more open and competitive, though often fenced in against imports from Japan.

Massive restructuring has already begun in these sectors, partly because of the approach of 1992 -- which combines the threat of new competition on a company's home market with new opportunities for expansion abroad -- but mainly due to the combination of soaring R&D costs and sluggish growth in the main national markets.

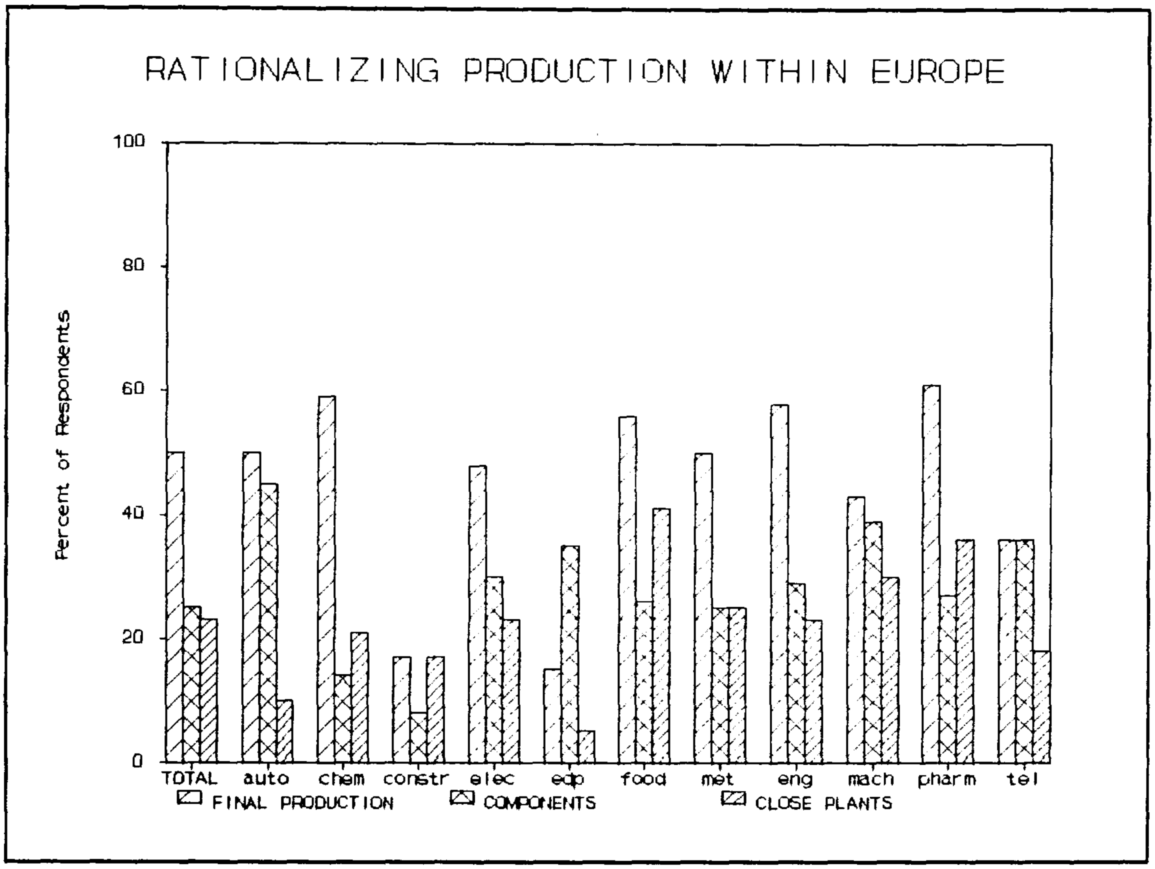
° In *telecoms*, the Alcatel/ITT merger in 1986 created the largest Europe-based telecoms group, second only to AT&T on a global scale. Meanwhile, non-EC firms have been moving in where possible -- Ericsson into France, Northern Telecom into Britain, AT&T into Italy.

° In *power equipment*, the 1987 merger of two EFTA-based giants, Sweden's Asea and Switzerland's Brown Boveri, formed ABB, the world's biggest group in this field. This triggered a whole series of restructurings and realignments in the power industry. While the new ABB, already strong in Germany, has been strengthening its position elsewhere in the EC through further acquisitions (in Italy, Spain, Portugal, the U.K.), France's Alsthom and Britain's GEC have responded by pooling their power equipment assets in a 50/50 venture that will be bigger than ABB within the EC though not worldwide.

° Even the *defence electronics* sector, which has long resisted cross-border restructuring for political reasons, has been shaken up by the GEC/Siemens attack on Plessey. Suddenly everyone is talking about possible alliances among the major players in defence and aerospace (France's Thomson, Matra and Aerospatiale, British Aerospace, the new German giant Daimler/MBB). As a French aerospace executive has stated: "What is clear is that there is going to be major restructuring in the European defence-related industries, and that it is going to happen very quickly."

In these and other sectors, the restructuring process will feed on itself as each major move (ABB, Daimler/MBB) destabilizes the competitive balance and accelerates further regroupings and realignments by others.

CHART A1.5



As competitive conditions vary widely from one sector to another, so will restructuring motives. In the capital-intensive basic chemicals industry, companies are repositioning themselves to concentrate on product lines in which they have special strength, or are joining forces to reduce surplus capacities through rationalization. In food processing, where potential economies of scale are found mainly in marketing rather than production costs, the commercial rationale is more often to buy market share in other EC countries. In the auto industry, structural adjustment is paralyzed by the presence of six almost equal volume producers (VW, Fiat, PSA, Ford, GM, Renault) with "Japan" as a seventh -- all with market shares of 10 to 14 per cent each. While outright mergers have been blocked (so far), joint ventures and other forms of collaboration are proliferating.

Despite these differences, some broad patterns are starting to emerge:

- As mentioned already, there is a general effort to refocus on core businesses -- a reaction against the diversification strategies of the 1960s and '70s. There are however some major exceptions: a few big firms (BAe, Daimler, Fiat) are diversifying within their home country; and some aggressive entrepreneurs (notably De Benedetti) are building cross-border conglomerates, snapping up undervalued assets through audacious bids.

- Vertical integration is equally unfashionable. As will be seen in Section A.2, both diversification and vertical integration trail well behind horizontal concentration as a motive for mergers or acquisitions.

° The level of restructuring is changing, from national to pan-European. This is well illustrated by the changing strategy of Britain's GEC. When he first bid for Plessey in 1985, GEC chairman Arnold Weinstock saw it as a move to consolidate and rationalize the U.K. electronics industry, much as his bids for AEI and English Electric had done for the electrical industry in the late 1960s. Though his bid was blocked by the Monopolies and Mergers Commission, it was followed by the pooling of GEC and Plessey's telecoms businesses into a 50/50 venture (GPT). By contrast, GEC's latest moves -- with Siemens, Alsthom and the U.S.' General Electric -- have a clear European dimension, offering scope for rationalization of intra-EC production and technology exchanges with powerful foreign partners.

° Rationalization of production on a European scale will be a major theme in the run-up to 1992. The business impact survey suggests that the emphasis in most industries will be on concentrating final production in specialized plants. Some sectors (autos, EDP, machinery, telecoms) also stress the need to consolidate production of components in Euro-scale plants. Closure of some plants will figure heavily in the food and pharmaceutical industries (see Chart A1.5).

Location

Initially at least, investments generated by the Single Market will gravitate toward countries and regions with the best infrastructures and skilled workforce. The survey results illustrate this tendency (see Charts A1.6-7). Whether as production sites for the domestic market or as export bases for EC and other markets, the "Big Five" (France, Germany, Italy, the U.K. and Spain) dominate the priorities of industrial investors, followed at a distance by the Netherlands, Belgium and Portugal. The pattern is much the same for service companies, except that the U.K. and Germany enjoy a clear lead.

CHART A1.6

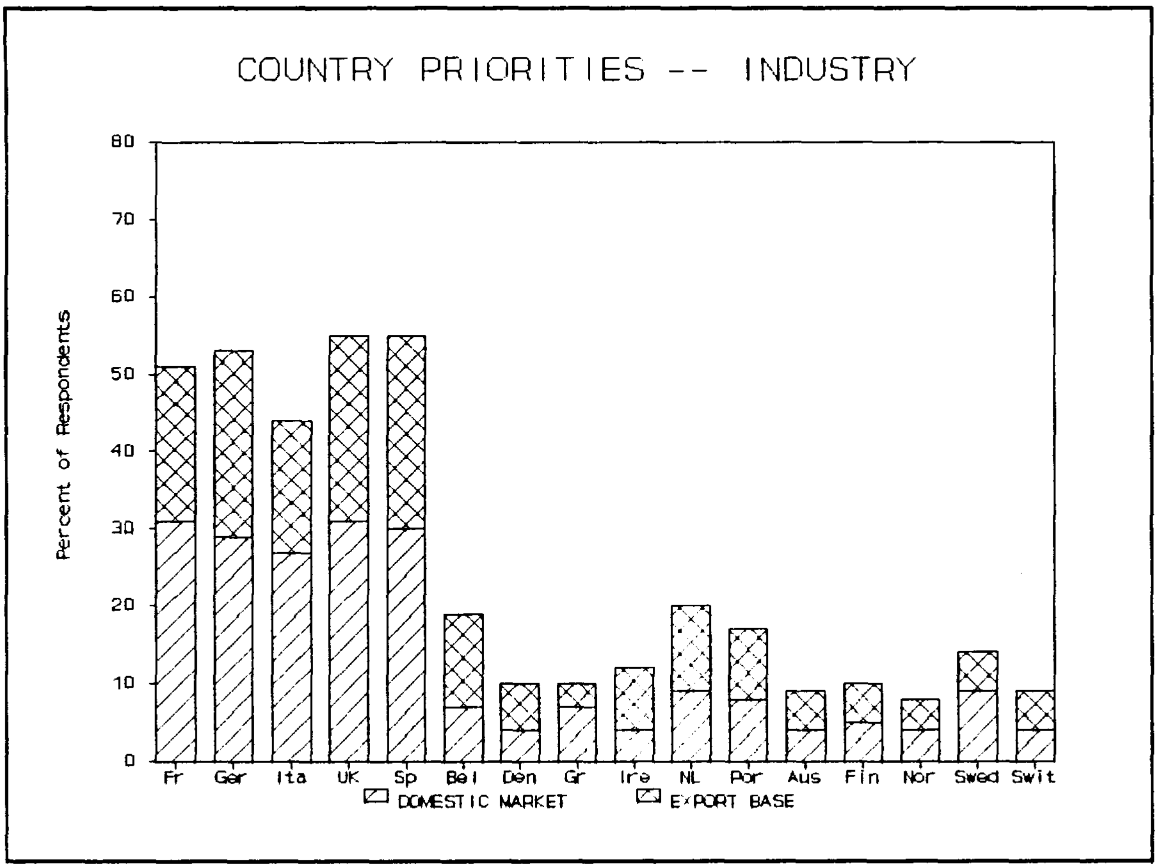
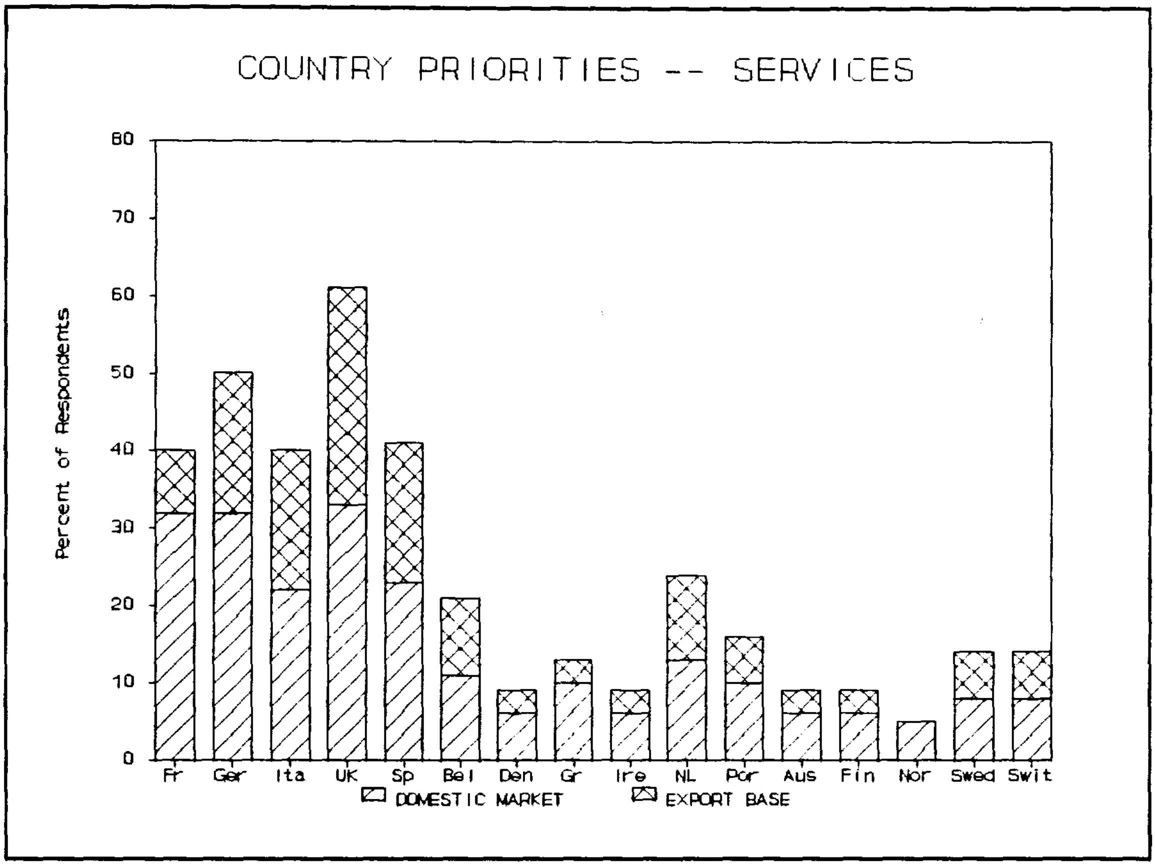


CHART A1.7



Survey responses have been sifted to exclude European firms' ratings of their own home country (which for obvious reasons always gets top priority). Thus they reflect the preferences of cross-border investors, whether of EC or non-EC origin. For EC industrial companies, the most attractive sites are the U.K. (for supplying the local market) and Spain (as an export base). EFTA companies prefer Germany on both counts, while North American firms favour the U.K. Finally, the Japanese give top marks to the U.K. (as an export base) and Spain.

A rough breakdown by sectors (Table A1.1) confirms the predominance of the Big Five. In the smaller EC and EFTA countries, the only top-priority ratings went to the Netherlands for food companies and Portugal for EDP firms, in both cases as an export base.

This pattern of investor preference raises the question of whether the unification of markets will aggravate disparities between the richer and poorer regions of the Community -- a real worry for the peripheral EC (not to mention EFTA) countries and for less favoured regions within the Big Five (see B.6). This issue was considered in the Cecchini Report, which drew reassuring conclusions from recent theories concerning international trade:

> "... the existence of economies of scale in many sectors, coupled with the differentiated nature of many products, promotes narrow specialization in certain fields of activity, which usually entails only reallocation within the same industry or even within the product range of the same firm.... [Moreover] there is no general basis for identifying in advance the Community regions and countries which will experience particularly serious and lasting redistributive problems."

The report added that "the redistributive effects empirically observed in the past (notably following the abolition of tariff barriers within the EEC) have been relatively slight."

Table A1.1 COUNTRY PRIORITIES BY SECTOR

(XXX = top priority, xx = secondary, x = little interest)

	auto	chem	elec	edp	food	met	eng	mach	pharm	tel	Services fin	bus
France												
domestic	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	xx	XXX	XXX	XXX
export	XXX	xx	xx	XXX	XXX	xx	XXX	XXX	xx	xx	xx	x
Germany												
domestic	XXX	xx	XXX	XXX	xx	XXX	XXX	XXX	xx	XXX	XXX	XXX
export	XXX	xx	XXX	XXX	XXX	XXX	XXX	XXX	XXX	xx	XXX	xx
Italy												
domestic	XXX	XXX	xx	xx	XXX	xx	XXX	XXX	XXX	XXX	xx	xx
export	xx	xx	xx	xx	xx	xx	XXX	xx	xx	xx	XXX	XXX
UK												
domestic	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	xx	XXX	XXX	XXX
export	XXX	XXX	XXX	xx	XXX	XXX	XXX	xx	xx	x	XXX	XXX
Spain												
domestic	xx	XXX	xx	xx	XXX	XXX	XXX	XXX	XXX	XXX	xx	xx
export	XXX	xx	xx	XXX	XXX	XXX	XXX	XXX	xx	XXX	XXX	XXX
Belgium												
domestic	xx	xx	x	x	xx	x	x	x	xx	xx	xx	x
export	xx	xx	x	xx	xx	xx	x	xx	xx	xx	xx	xx
Denmark												
domestic	x	x	x	x	x	x	xx	x	x	x	x	x
export	x	xx	x	xx	x	xx	xx	x	xx	x	x	xx
Greece												
domestic	x	xx	x	xx	xx	x	x	x	xx	x	x	xx
export	x	x	x	xx	x	xx	x	x	x	x	x	x
Ireland												
domestic	x	x	xx	xx	x	x	x	x	x	x	x	x
export	x	xx	x	xx	x	x	x	xx	xx	xx	x	x
Netherlands												
domestic	x	xx	x	xx	xx	x	xx	x	x	xx	x	xx
export	xx	xx	xx	xx	XXX	x	x	x	xx	xx	xx	xx
Portugal												
domestic	x	xx	xx	xx	x	x	x	xx	xx	x	x	xx
export	xx	xx	x	XXX	x	xx	xx	xx	x	x	x	xx
EFTA countries:												
Austria												
domestic	x	x	x	x	xx	x	x	x	xx	x	x	x
export	x	x	x	xx	x	x	x	xx	x	xx	x	xx
Finland												
domestic	x	x	xx	x	x	xx	x	x	x	x	x	xx
export	x	x	xx	x	x	x	xx	x	x	x	x	xx
Norway												
domestic	x	x	xx	x	x	x	x	x	x	x	x	x
export	x	x	x	x	x	x	x	x	x	x	x	x
Sweden												
domestic	xx	x	xx	xx	x	xx	x	x	x	xx	x	xx
export	x	x	xx	xx	x	xx	x	x	xx	xx	xx	xx
Switzerland												
domestic	x	x	x	x	x	xx	x	x	x	x	xx	x
export	x	x	xx	x	x	xx	x	x	xx	xx	xx	x

The Single Market, however, is a new phenomenon for many sectors. In pharmaceuticals, for example, one survey respondent (the French manager of a U.S. multinational) predicted that investment will gravitate toward those countries that already have a strong drug industry. And the same logic will apply at the individual company level:

> "MNC drug firms like ourselves would definitely like to concentrate production in fewer plants. We could produce a limited range of products in longer runs for all EC markets, with different packaging conforming to each country's requirements. We have factories in the U.K., Germany, Italy and Spain, but so far we have no plant here in France -- we subcontract production to a local firm. So if I don't get one approved by 1992, it will be too late."

Multinationals in other industries are or will be rationalizing their European production facilities in preparation for 1992. Some examples:

- An American telecoms firm: "Clearly, one can't have manufacturing facilities in every European country. The idea is to have specialized units making one product at which they're best, and then exporting it to other units. There will be a lot of transnational exports and imports. Though it is true that governments will be anxious to retain manufacturing operations and avoid MNCs restructuring themselves out of their countries, there is ultimately very little they can do about it. Unless companies achieve economies of scale, they will go under. Continuous refocusing and restructuring is the name of the game."

- A U.S. electric lighting manufacturer: "Rationalization of production is important. We will probably concentrate production of incandescent lamps in one country; currently we produce them in both France and Belgium. Production of fluorescent lamps at a smaller-scale facility in the U.K. will be moved to Germany; the U.K. unit will be used for other products. We are always looking at rationalization and cost-cutting. But we expect to speed up such efforts in view of 1992."

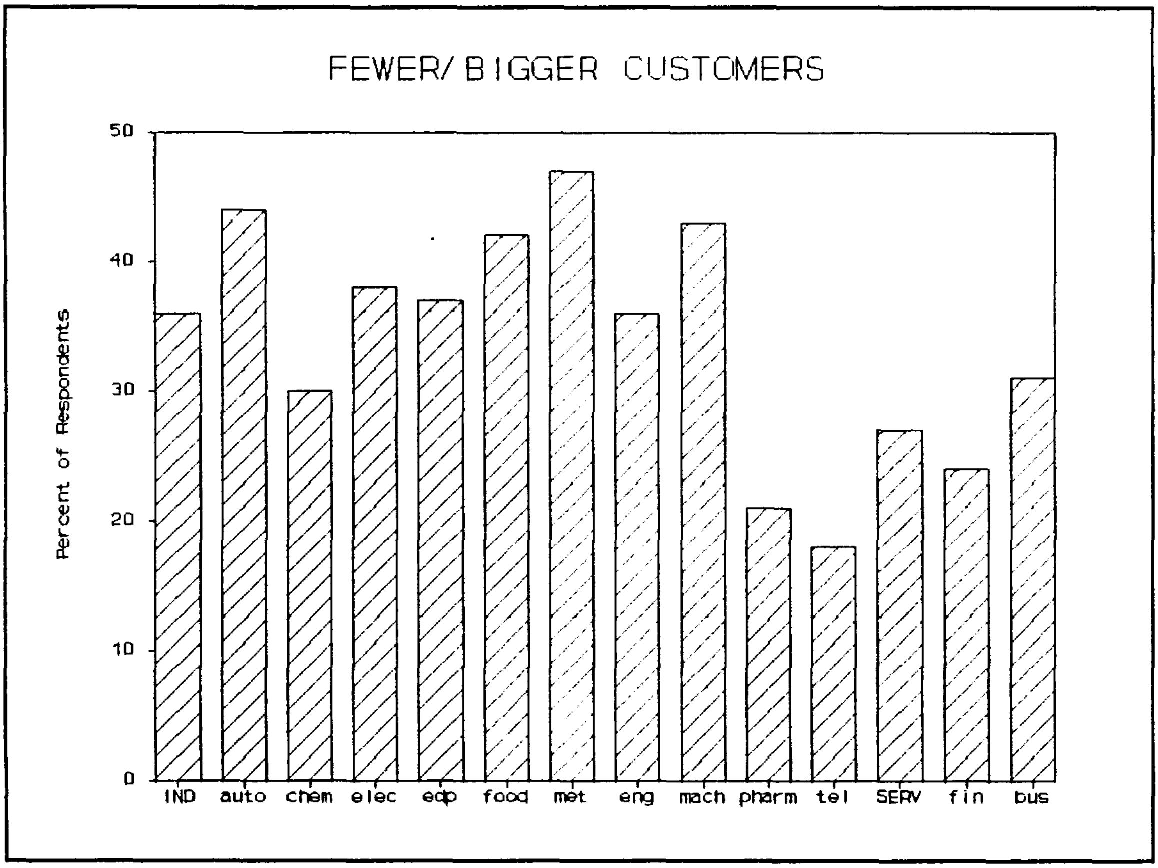
- For Bekaert, the Belgian steel wire manufacturer, 1992 offers the opportunity to create a network of world-class manufacturing facilities that can achieve economies of scale not possible with today's plethora of border restrictions and controls. Its European plants will progressively concentrate on making just one of the company's main product lines (steel cord or one of three steel wire products). However, Bekaert is not going to abandon its wide-ranging network of factories, since its customers are increasingly demanding close proximity to key suppliers -- both to cut inventory costs through using JIT (just-in-time) techniques and to ensure greater product quality.

- The most radical change is being undertaken at Otikon, a Danish producer of hearing aids, which plans to restructure its whole organization, not only in Europe but worldwide. The company has an international spread and exports 95 per cent of its production. Its foreign subsidiaries (in nine European countries, the U.S., Japan and New Zealand) have traditionally carried out all functions, from assembly to marketing and distribution. In future, all production, repair and maintenance, and inventory activities will be concentrated with the mother firm. Subsidiaries outside Denmark will be left only with responsibility for sales, marketing and distribution. This should lead to substantial cost savings, which will be plowed into stepped-up R&D activity.

How will European companies change as customers?

From the business impact survey results and from interviews, the most common answer to this question is that corporate customers in the post-1992 era will be fewer and bigger. This consolidation of the marketplace was identified by 36 per cent of executives surveyed as having a strong impact on their industry, with another 36 per cent claiming it would have a moderate effect. The highest ratings came from metals/minerals and automotive firms. (The latter group includes auto parts makers selling to assemblers, and assemblers selling to dealers.) The trend is less apparent for service companies, with 27 per cent rating it as a strong and 39 per cent as a moderate effect (Chart A1.8).

CHART A1.8



Some relevant observations from the interviews:

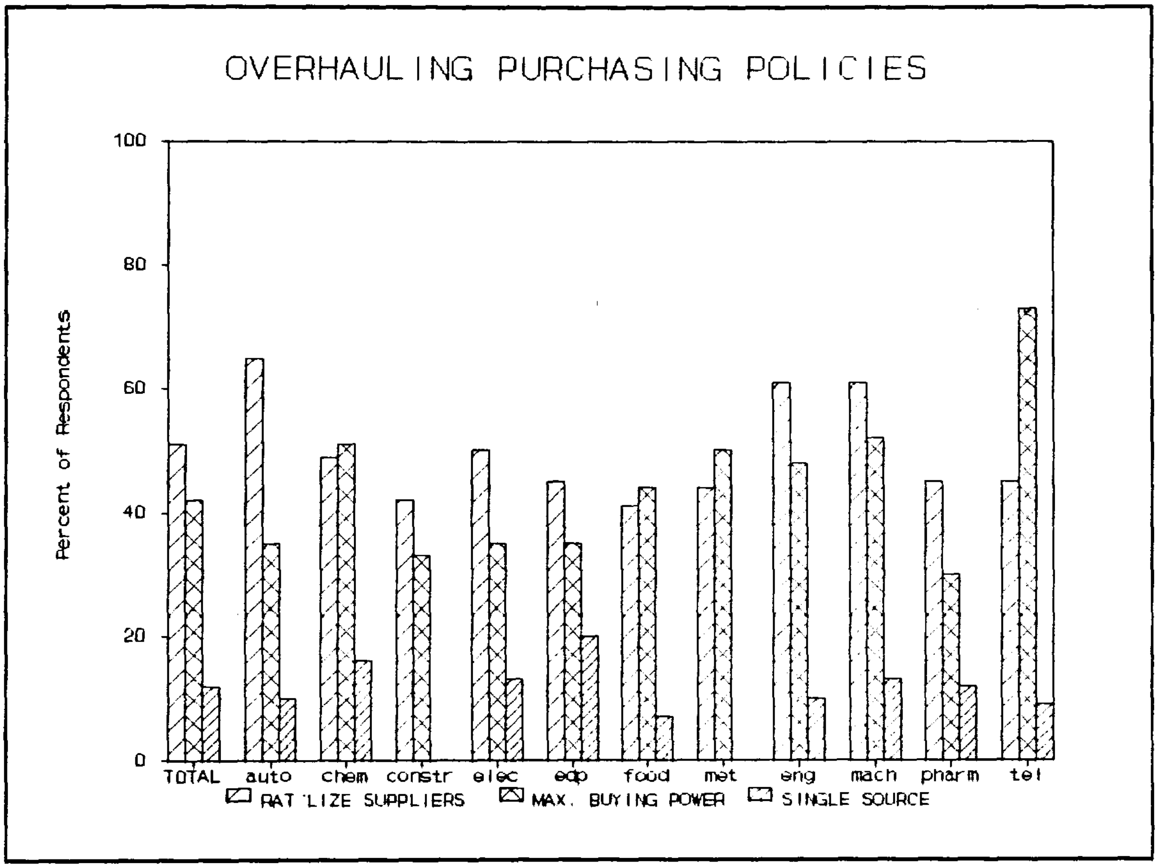
- A German banker: "Canadian firms will have to deal with larger EC firms. This includes small firms becoming medium ones, and in Germany there will be many efficient medium-sized firms.... 1992 will not be a revolution, but an evolution; on January 1, 1993, the world will look the same. But much that was in the pipeline anyway is being speeded up."

- A U.S. computer maker: "The large company environment will mean Europe-wide pricing and discounting and more high-level selling, with deals struck at European headquarters rather than at national levels." This firm also expects that some of its national-champion customers will be in trouble, forcing them to cut back purchases. "In four or five years," says the executive, "the EC customer landscape will be completely changed."

- A medium-sized Swiss food company: "Distributors' growing market power will force manufacturers to give bigger bonuses at yearend as well as more service. There will be pressure on prices and elimination of small- and medium-sized non-specialized firms."

How companies plan to adjust their own purchasing policies is shown in Chart A1.9. The main emphasis will be on rationalizing supplier networks, especially in the automotive, mechanical engineering and machinery sectors. In chemicals, food, metals/minerals and especially telecoms, the stress will be on concentrating orders to maximize buying power. But few companies in any sector are prepared to go so far as relying on single-source suppliers.

CHART A1.9


OVERHAULING PURCHASING POLICIES
Percent of Respondents
100
80
60
40
20
0
TOTAL
auto
chem
constr
elec
eqp
food
met
eng
mach
pharm
tel
RAT'LIZE SUPPLIERS
MAX. BUYING POWER
SINGLE SOURCE

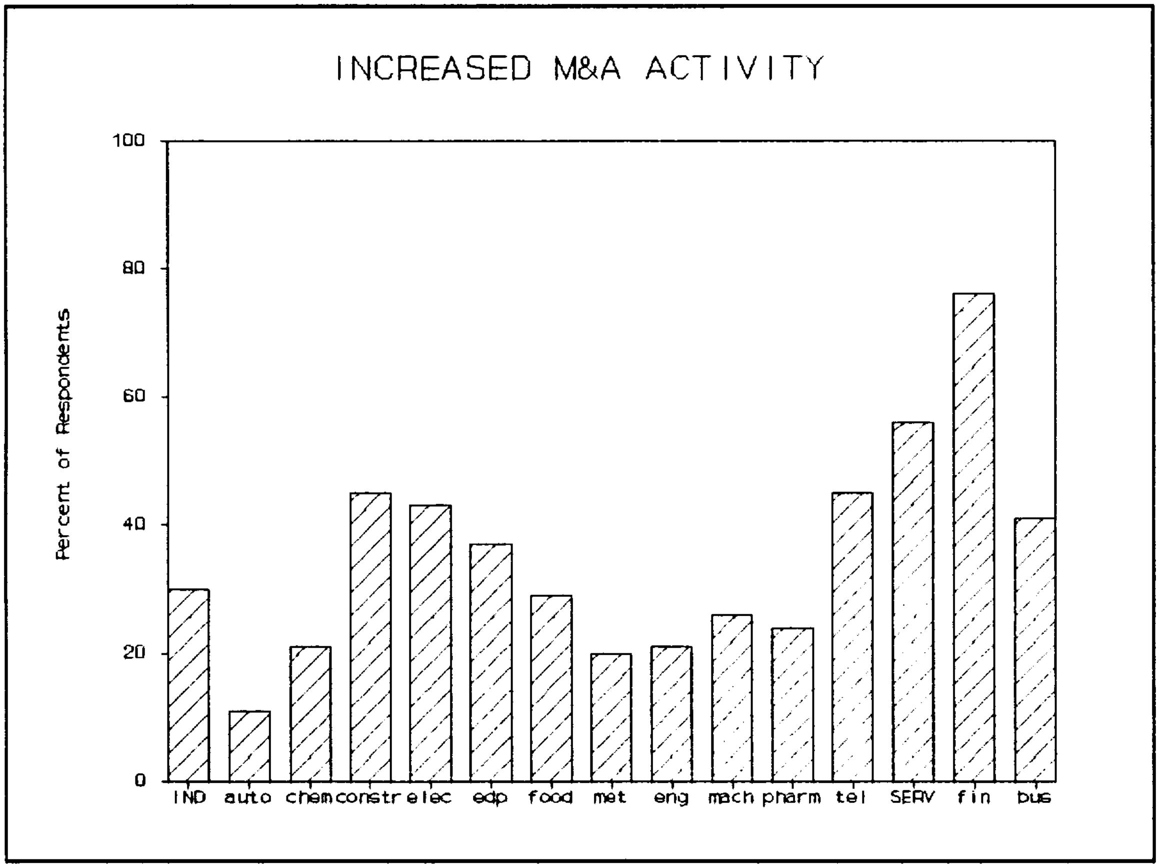
A.2 (M&A) MERGERS, ACQUISITIONS, JOINT VENTURES AND ALLIANCES

The restructuring process described in the preceding section will often take the form of mergers and acquisitions (M&A), joint ventures (JVs) and other types of corporate alliances. The threats and opportunities of the Single Market have already led to an unprecedented surge of takeovers and linkups within Europe. At one extreme are the high-profile megadeals, whether hostile public takeover battles (Nestlé/Rowntree, GEC/Siemens/Plessey), voluntary cross-border mergers (ABB, Carnaud/Metal Box) or government-backed or -arranged domestic marriages (Daimler/MBB, Enimont). Behind these lie a host of smaller and less publicized deals, often involving unquoted companies.

Industry patterns

In the business impact survey, 30 per cent of the industrial and 56 per cent of the services sample predicted that increased M&A activity in their sector will be a strong impact of the 1992 program (Chart A2.1). The highest ratings came from financial services (banking and insurance), telecoms, construction/building materials and electrical/electronics, and the lowest from the auto industry.

CHART A2.1



When asked about their own company's plans for the coming years, rather than the general impact on their sector, the respondents put much greater emphasis on M&A (see Chart A2.4). In industry as a whole, the proportion giving it a "strong" rating more than doubled, from 30 per cent to 71 per cent. For telecoms and construction firms it was over 90 per cent (versus 45 per cent for their industry), and even in the auto sector -- still the lowest -- it jumped from 11 per cent to 40 per cent. In the service sectors, however, the overall increase was less dramatic, and in financial services only 67 per cent thought M&A would be important for their own companies (versus 76 per cent for their sector as a whole).

The varying stress on M&A reflects the differing structural and competitive situations in specific sectors. For some companies, acquisition is the best or even the only route to expansion; for others it is fraught with difficulties. Some illustrations from interviews conducted for this report:

- In the *food industry*, the Swiss giant Nestlé was Europe's biggest acquirer in 1988, spending well over $6 billion to strengthen its position in key product markets through major purchases such as Rowntree (U.K., chocolates) and Buitoni (Italy, pasta).

- In *pharmaceuticals* -- an industry with little tradition of M&A or joint venture activity, at least in Europe -- two U.S. drugmakers agree that things are changing, mainly because R&D is becoming more and more expensive. Says one: "Unless you have a certain market share -- say the top 10 to 12 companies -- in the long term it will be difficult to remain independent." The other points to the need to acquire a local marketing force, given the short lead time on drug patent exclusivity: "This has been a really big change in the past 10 years."

- In *computers*, R&D is again a driving force. One U.S. company is making a major M&A effort worldwide. "For the moment, the activity is mainly in software. We are taking minority positions rather than full takeovers. There are three reasons for this effort: (1) we can line up with creative software as it is developed and keep it available for our equipment; (2) we thus keep the software partner independent and working under its own original creativity instead of losing it in a big firm; and (3) hopefully we get a good and profitable investment."

- In *retail distribution*, there are mixed views. A British chain store expects little cross-border M&A activity as a result of 1992. "Local markets are too different. There are no obvious economies of scale. Increased buying power might be one benefit, but this doesn't necessarily require a full merger. For example, we might consider a linkup with [a German firm] to combine our purchasing leverage."

- On the other hand, the Belgian retailer GB-Inno-BM is acutely aware of the need to grow beyond its small home market. "We are number one in Belgium," says chairman Franois Vaxelaire, "but number 22 in Europe.... Our group is willing to respond to the challenge [of the Single Market] and wants to position itself now to meet that challenge head on." Its growth strategy outside Belgium is to focus on setting up franchises and acquiring shareholdings in selected companies -- not necessarily a majority stake, but enough to achieve control. In the do-it-yourself field, for instance, GB-Inno-BM has struck deals with firms in Spain, France and the U.K., with the goal of building a European network of 200 do-it-yourself stores held together by minority shareholdings and unified management style.

- And an expansion-minded French hypermarket chain says bluntly: "M&A will increase. There are countries where startups are nearly impossible, and acquisition is the only route.... Joint ventures will increase as well. We have JVs in Argentina, Spain and Switzerland -- we're the majority shareholder in the first two, minority in the latter because of Swiss law." Germany is of less interest because of its rigid opening hours, but "if that changes, Germany becomes an *extremely* interesting market."

- In the *elevator* business, the Finnish multinational, Kone, has used M&A to build an empire that now extends to 35 countries on five continents. As president Matti Matinpalo points out, "The elevator business is difficult to develop without acquisitions since it requires a solid local base, particularly for servicing; but a proper operational base is hard to build from scratch." So Kone has bought an average of two to three elevator companies a year, most of them in Europe. It now claims to be the third biggest elevator manufacturer in the world, and can look forward with confidence to 1992.

- In *telecommunications*, other factors dictate the need for acquisitions and alliances. For a U.S. telecoms firm, "Those things become important tools in our bag because in some countries there's no real way to establish a business with the greenfield approach. What you need to do is either buy someone else's business or join forces with a local firm that has good contacts, good relationships with the customers you want to do business with."

- As noted earlier, *financial services* are expected to be the sector most strongly affected by M&A. Asked to speculate on likely targets, a German banker replied: "The ones most susceptible will be the choice plums, which are interesting *per se*; and those with problems -- management, financial or whatever.... But the goal is not bigness alone. In banking, the largest are not the most profitable -- usually it is the smaller banks. But they must be quality banks."

- A bank director in Milan highlighted the obstacles to national mergers in its industry. "Italian banks are relatively small and scattered; they are also highly regional, which makes merging difficult." On top of this, Italian banks are divided by political affiliations, "something which is quite sticky to co-ordinate in a merger." In fact, he thinks it is much easier for a foreign bank to buy into Italy than for another local group, and suggests that freshly merged banks will become takeover targets: "The new mergers will probably remain weak for as long as two to three years because of the difficulties of putting these deals together, and it would be easy for a foreign bank to step in and take charge." Already there have been some joint ventures with foreign partners in merchant banking (BCI/Paribas, Euromobiliare/Midland).

- The insurance field is in as great a ferment as banking. Two big Swiss insurers interviewed for this report have gone on an acquisition binge in the past two years -- especially in Italy and Spain -- to reinforce their already strong position in the northern EC and secure a stake in these growth markets of the south.

- Meanwhile, Raul Gardini's Ferruzzi group has targeted insurance as a growth area beyond 1992. Currently number three in Italy, through Fondiaria, the group has acquired a 25 per cent interest in the second largest German insurance firm and, says Gardini, "we will be shopping around some more." However, he adds that in this sector, which he describes as "calm and conservative," the building of alliances is more important than actual control.

M&A strategies and motives

Of the three basic acquisition strategies -- horizontal, vertical or diversification -- companies surveyed overwhelmingly favour the first (Chart A2.2). This is true in all but three of the industrial sectors (autos, chemicals and construction/building materials), where diversification goals are as important or more so. Vertical integration strategies are relatively uncommon except in telecoms, metals and chemicals. In financial and business services, however, no single strategy prevails.

The M&A motives cited by executives are many -- to buy market share, to compensate for low internal growth potential in key business areas, to prepare for European integration, to meet competition from bigger U.S. firms, or simply to grow:

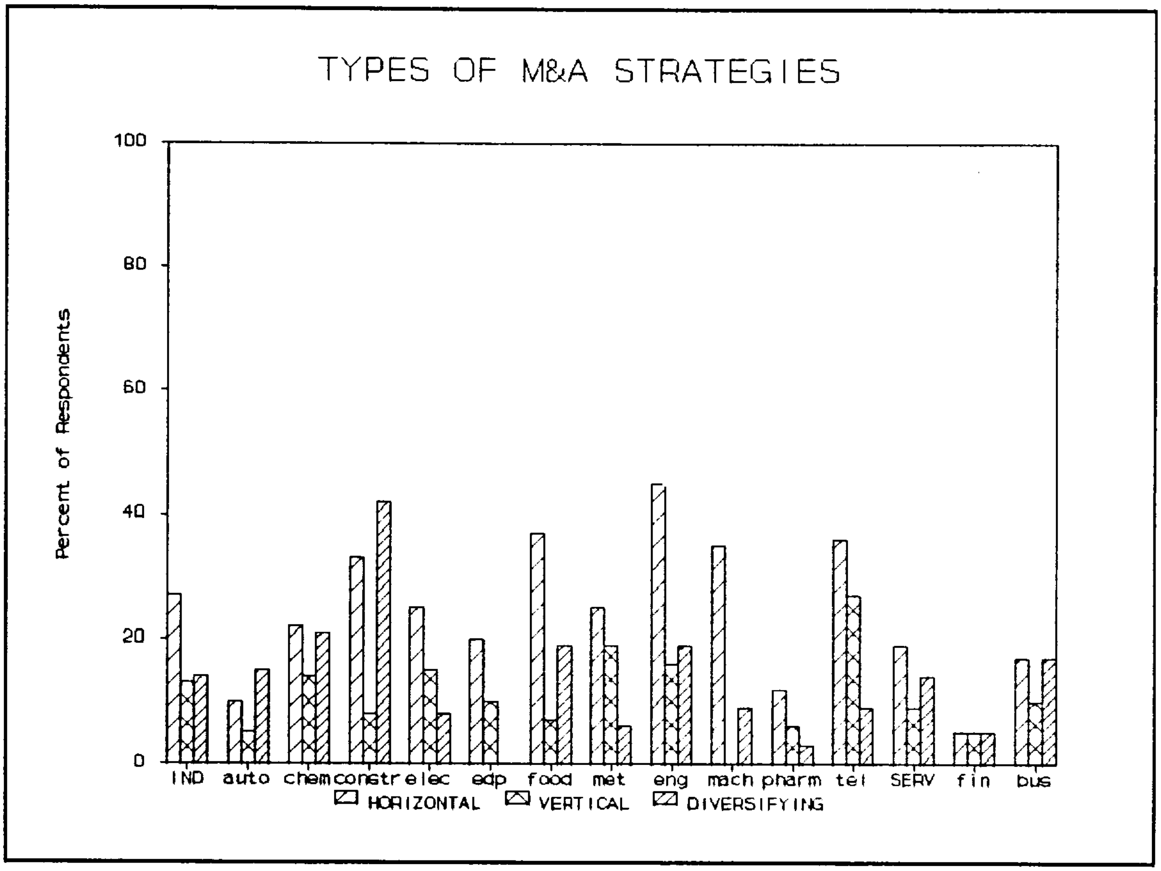
- For a Swiss food company, production within the Single Market is needed to avoid protectionist technical barriers. But creating new capacity makes no sense in an already saturated market. "In our business, there is really little volume growth because the European population is not increasing rapidly. So we are using M&A to buy market share."

- A trio of Swedish pulp/paper giants expressed various motives for their M&A activity. The first, Svenska Cellulosa (SCA), is pursuing vertical integration to move toward higher value-added, consumer-related areas such as hygiene and packaging, and away from an overriding dependence on lower value, cyclically volatile products such as pulp. Says president Bo Rydin: "This new consumer orientation, highlighted by last year's acquisition of the French hygiene company Peaudouce, has been long in planning and will have an increasingly dominant position in SCA's long-term strategy."

  The second, MoDo, has put together a series of domestic acquisitions, both horizontal and vertical (Holmen, Iggesund), with the objective of building a broadly based forestry group less susceptible to pulp price fluctuations and able to compete internationally. As chairman Matts Carlgren notes: "The Swedish forestry industry needs larger companies to meet competition, chiefly from the North Americans." The takeovers also increased MoDo's presence in EC markets, particularly the U.K. and Germany.

  At the third, ASSI, a major restructuring program is designed to refocus the group within Europe ahead of 1992. As the corporate development director explains, this involves both acquisitions and disposals. But, he stresses "1992 as such is not the driving force; it's competitive positioning." For example, ASSI in 1987 acquired a major British corrugated box company, and in 1988 it sold off a number of sawmills in Sweden. "It was a question of either putting a lot of money and effort into those businesses long term or of concentration, and we chose the road of concentration.... So we have these three keywords in the company: packaging paper, corrugated boxes, and Europe as the home market."

CHART A2.2



° Italy's Carlo De Benedetti, like his countryman Raul Gardini, is bucking the current M&A fashion by building a conglomerate on a pan-European scale. But the strategy, as outlined by Corrado Passera, general director of the group holding company CIR, is "to consolidate our position in areas where we can play a leadership or co-leadership role in Europe." Thus the group divested its food business (Buitoni) after being barred from acquiring the state-owned food company SME, which would have given the overall business the critical mass needed to join the food industry's major league.

The cornerstones of the De Benedetti group's long-term strategy are now information technology, publishing and industrial machinery. But it also keeps an eye out for medium-term investments in other areas -- companies it thinks can be turned around and sold at a profit, such as Yves Saint Laurent (fashion) or Credito Romagnolo (banking).

De Benedetti's investment formula is also original in the way he approaches each national market "from the inside." Speaking of his local holding companies in France (Cerus) and Spain (Cofir), De Benedetti explains that these "enable us to operate in individual countries through a national operation similar to what we use in the Italian market. Our international growth model is to operate as a group in each country through locally listed companies and with local managers, forming alliances with the most prestigious and representative groups and institutions of that country." The same formula is now being extended to Portugal and Greece.

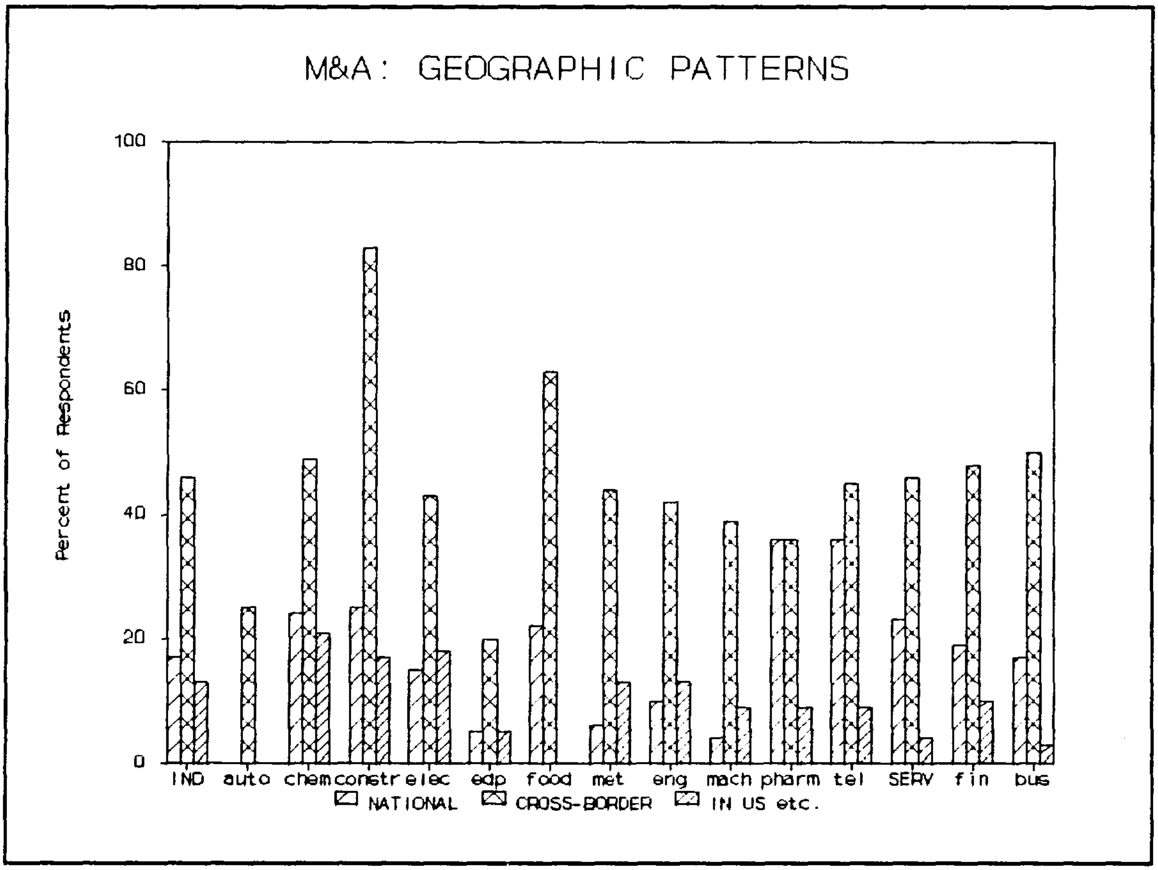
Ultimately, De Benedetti dreams of creating a major pan-European holding company, a role he had envisioned for Société Générale de Belgique. But after the 1988 scuffle over control of SGB, he was left with only a 16 per cent share. Despite this set back, the group remains firmly committed to its European holding strategy. As a company spokesman put it, "If we can't get SGB to work, we'll just look somewhere else."

Despite all the activity on the M&A front, many observers remain skeptical of the results. Critics have questioned the logic of many mergers, especially those motivated by the simple desire for so-called critical mass. And most research studies over the years have concluded that the failure rate of acquisitions is 50 per cent or more. Referring to the well-known difficulties of uniting two company cultures, one Danish banker commented sardonically: "I often hope that my two worst competitors would merge. That would give me time to conquer the market."

Geographic patterns

A striking feature of the survey is the overwhelming predominance of cross-border (intra-European) M&A plans over purely national deals (Chart A2.3). This applies in every industrial and service sector, with the sole exception of pharmaceuticals. In the auto industry, which appears generally averse to M&A, cross-border deals were the only area of strong interest.

CHART A2.3



By comparison, few respondents indicated that their companies would be emphasizing acquisitions in the U.S. and elsewhere. This may reflect the primarily European focus of the survey. Certainly it does not jibe with the current heavy traffic of European acquirers in the U.S. — particularly British firms, which in 1988 spent some $32 billion on U.S. takeovers, against less than $3 billion in Continental Europe. While the U.K.'s transatlantic bias is exceptional, German, French and other EC companies are also looking westward for broader opportunities. As an M&A specialist at Belgium's SGB has said, "At the moment we're interested in the EC of course, but that doesn't mean we aren't looking to the U.S., or to Japan."

At the same time, it remains true that 1992 has given rise to an upsurge of cross-border acquisitions and other corporate linkups within Europe, both large and small.

Joint ventures and alliances

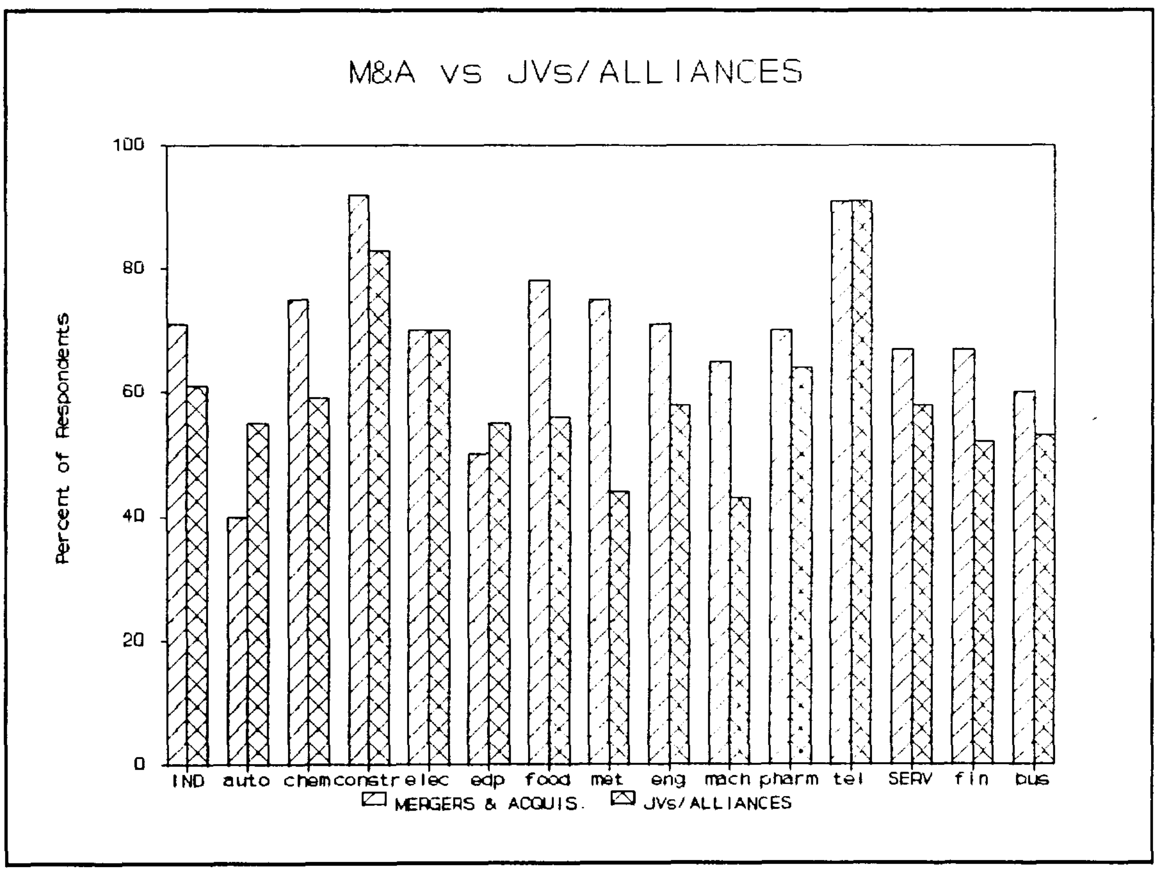
Beyond straight acquisitions, the globalization of markets and the advent of the EC Single Market have triggered an explosion of cross-border co-operation deals between companies that retain their independence -- and often remain competitors in other areas.

These corporate alliances take a variety of forms, from equity joint ventures or cross-shareholdings to contractual relationships. The co-operation may focus on R&D, OEM sourcing or joint production, cross-marketing and distribution, or venture capital-type relationships. And they are proliferating in many industries -- particularly in telecoms, electronics and electrical engineering, but also in autos and commercial vehicles, food, packaging, software, financial services and so on.

One close observer, Tom Lewis of the Boston Consulting Group, argues that alliances are preferable where an acquisition "would represent overkill, or overpaying." Control may not be necessary if the strategic objectives are limited, or it may not be feasible. Examples are when the aim is to gain access to a major company's distribution system or technology; where successful innovation requires co-operation between two big companies; where a big firm doesn't want to stifle innovativeness in a small hi-tech company; or with service companies "where the human assets can walk out." Sometimes appropriate acquisition candidates are not available, or the post-acquisition risks are unacceptably high. ("The integration risk is higher as you diversify into unfamiliar businesses or countries.")

The survey results (Chart A2.4) show that interest in joint ventures and alliances is nearly as great as in M&A, and in some industries (autos and EDP) greater. Two thirds of the EC and EFTA firms, and three quarters of the small Japanese sample, indicated that JVs/alliances would get strong emphasis in the coming decade; among U.S. firms, however, the figure was just over half.

CHART A2.4



As BCG's Tom Lewis observes:

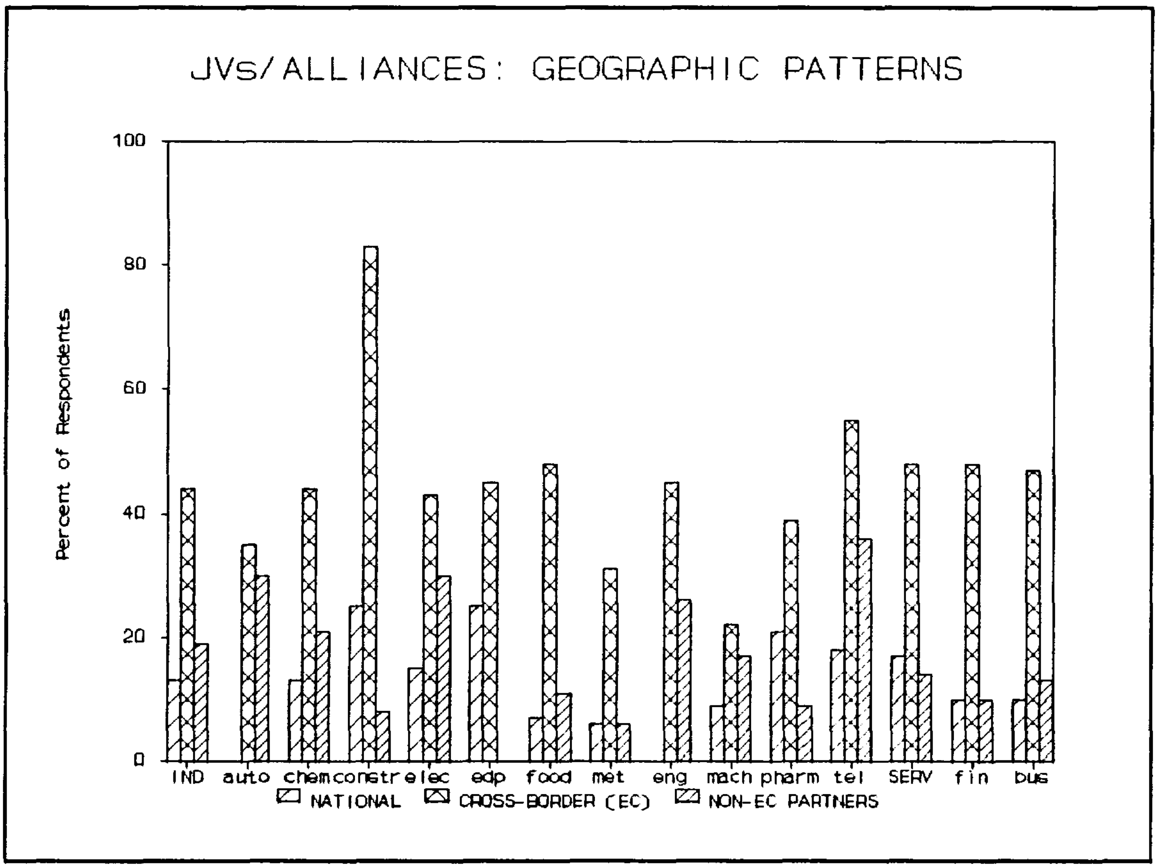
> "U.S. companies have an acquisition bias -- they want control. But many European and Japanese companies have a bias toward the alliance route. Siemens, for example, has been much more aggressive in alliances than in M&A. I think 1992 may lead to a greater surge of intra-EC alliances than acquisitions."

As with M&A, cross-border linkups with EC partners are the dominant pattern, although alliances with non-EC firms come second, ahead of purely national deals (Chart A2.5). Here are two relevant comments from interviews conducted for this report:

- A German automaker: "It is unlikely that we would decide to concentrate only on Europe. Maybe we will seek more co-operative ventures inside Europe -- possibly with a U.S. or Japanese manufacturer, not necessarily with an EC firm. For us, efficiency is more important than nationality in such a partner. We would not enter into such a venture for political reasons."

- A Spanish telecoms equipment manufacturer: "We search for linkups with the most important companies we can find, like AT&T. But we don't have much to contribute to alliances in telecoms except our own pre-eminence on the Spanish market -- a potential big market with 40 million people. It's our only weapon. So alliances must work both ways: give me at least a part of the U.S. market in exchange for Spain."

<u>CHART A2.5</u>



Will existing co-operative relationships between Canadian and European firms be upset or subsumed in widespread reorganizations? Alliances are always unstable; the death rate is even higher than for acquisitions -- up to 80 per cent according to some recent studies. But the business impact survey does not suggest that companies in Europe are rethinking their present alliances because of 1992 as such. Only 10 per cent of EC firms, and even fewer from EFTA, indicated that they would be reviewing or terminating existing alliances. As a U.S. telecoms executive points out, however:

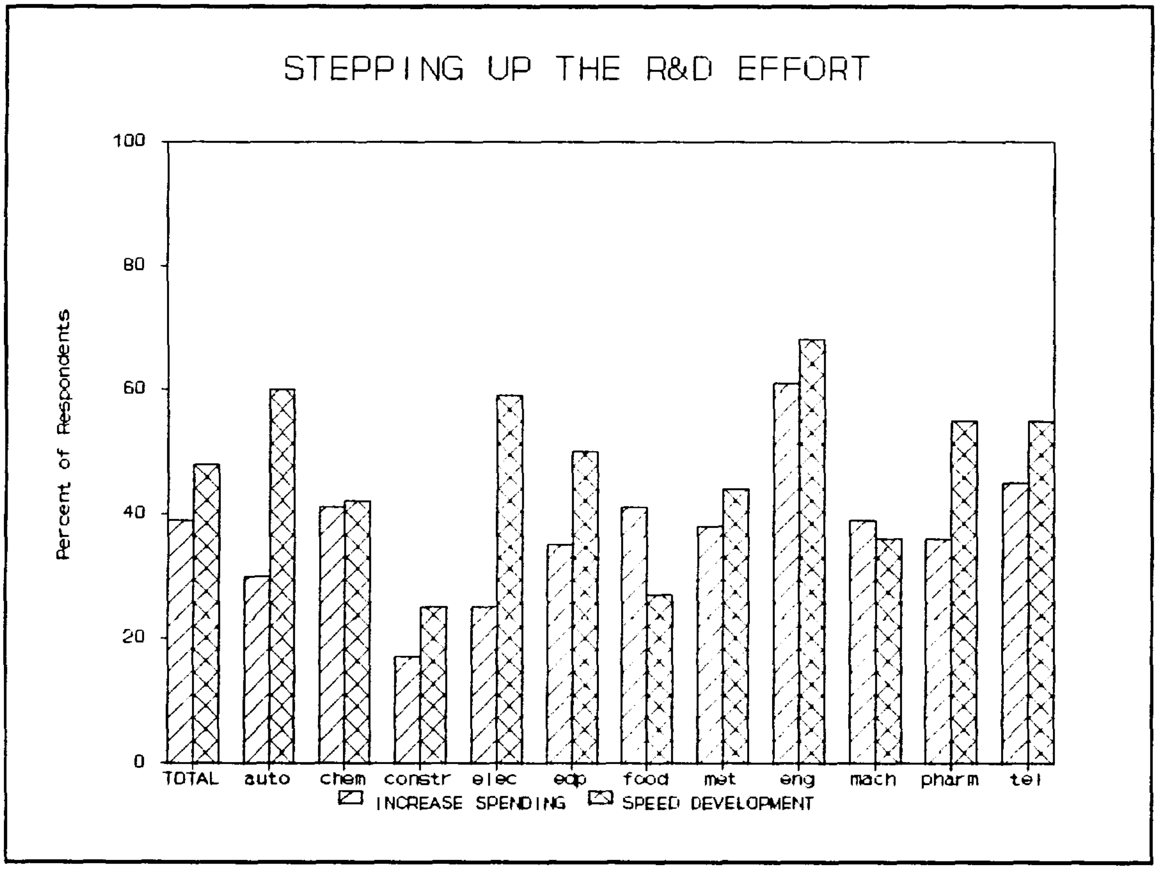
"I guess you could say nothing is forever. In any joint venture the partners at the instant of the deal have certain objectives, and if you've done the groundwork well, those objectives link together very well at the time of the deal. But it's very likely that as several years pass the partners will diverge in their interests...."

A.3 RESEARCH AND TECHNOLOGY MANAGEMENT

Research and development (R&D) is a management area that few companies expect to be strongly affected by the Single Market program. In the business impact survey, only 18 per cent of industrial respondents foresaw such an impact -- the lowest rating for any aspect of their business. But auto, metals/minerals and especially telecoms companies gave significantly higher ratings. And 29 per cent of all industrialists -- including over half of those in telecoms and pharmaceuticals -- mentioned new product development as an area that would be strongly affected.

Nearly 40 per cent of industrialists plan to increase R&D spending as a percentage of sales, and nearly 50 per cent cite the need to reduce product development times (Chart A3.1). Mechanical engineering firms put the greatest stress on both these objectives, while several other sectors (autos, electrical/electronics, EDP, pharmaceuticals, telecoms) also gave high emphasis to faster product development.

CHART A3.1



The role of R&D as a competitive factor was stressed frequently in the interviews conducted for this report, by large and small firms alike. Here are two typical comments:

- A Finnish forest products company: "I think that research and development in general -- perhaps regardless of the EC -- is increasing all the time, at least in our company. And we are emphasizing it more and more. We just went through the investment budget for the next 12 months and there's a big jump in comparison to 1988. So R&D efforts -- both in terms of equipment and human resources -- are steadily increasing."
- A Spanish producer of auto batteries: "You must have strong R&D to differentiate your products and develop new ones. You can't avoid it if you're going to stay in our industry. We have our own R&D department and a technical assistance contract with a

U.S. firm, the biggest in the world, for pure research. We can't cover the whole field ourself."

Hi-tech companies in particular stress the importance of spreading R&D costs over a broader market base. The lack of such a base has long been cited as a key competitive handicap of EC hi-tech firms against their U.S./Japanese rivals. This is also a prime driving force behind the globalization of markets. As an Italian chemical company put it, referring to the work it is doing on sophisticated new fibers for supersonic airplanes:

> "The kind of money you have to spend on R&D to develop these miracle materials is tremendous; you have to be thinking of a global market in order to make some money on your investments."

Will R&D efforts be accelerated by economies of scale in producing for a bigger market? Or will companies concentrate on achieving market control? Achieving high market share, if not control, is a precondition for the critical mass that underlies R&D. But the opposite also holds, and not only in hi-tech industries. As a Finnish forest products executive explains:

> "We see that those two things really should go hand in hand, so you can't really separate them out. When you get a stronger position in the marketplace, you create more volume and that way you are able to invest more money in R&D. When you do that, you improve your position in the marketplace. It's a circle."

R&D collaboration is seen by many as a way of squaring this circle, a shortcut to critical mass in the research function. Over 40 per cent of EC and EFTA firms surveyed expect to participate in joint projects under the R&D programs, EUREKA, ESPRIT, RACE, etc. (see B.8). In some cases R&D co-operation creates alliances between the European giants (e.g., the Philips/Siemens megachip project) or even leads to partial mergers (SGS/Thomson). Others involve established networks of small firms, as in the fast-growing opto-electronics field (lasers, optical fibres, VDUs, etc.). In still other cases, major European producers have joined forces with U.S. or Japanese partners that are leaders in the technology (Philips/DuPont Optical, ICL/Fujitsu).

Managing Europe-wide R&D

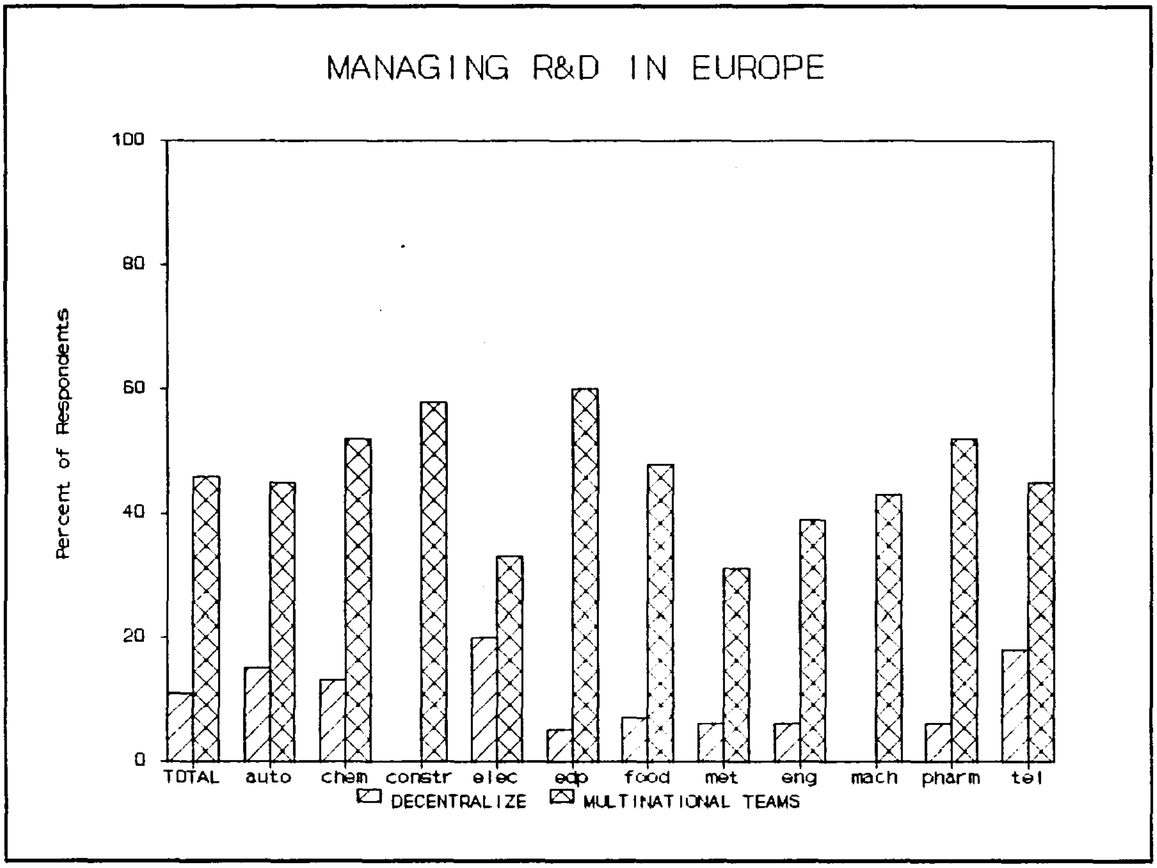
How will the growing integration of European markets affect R&D management? The survey results indicate that most companies will not seek to decentralize R&D, but rather to develop multinational research teams (Chart A3.2).

Several of the companies interviewed for the present study were grappling with the issue of how best to organize the R&D function in a multinational company:

- Olivetti has recently reorganized to develop a decentralized yet integrated approach to R&D, backed by increasing resources (6 per cent of sales). Its former centrally operated R&D unit has been replaced by a network of eight strategically placed labs -- five in Italy and one each in the U.K. (Cambridge), Germany (Nuremberg) and the U.S. (Menlo Park). Research vice-president Dr. Hermann Hauser feels strongly about the advantages of smaller, strategically placed R&D centres: "The bigger the lab is, the more bureaucratic it becomes, which doesn't help your creative efforts." He also sees a marketing benefit in having R&D facilities close to customers: "It is impossible to keep in touch with all the findings and changes around the globe without going to where things are happening."

- Svenska Celulosa is reorganizing its R&D division to integrate this function between the parent company and its newly acquired foreign subsidiaries. "This will lead to a concentration of basic research in a few places and in a few areas where we have a strong position today," states a company executive. There would also probably be an exchange not only of personnel but also of development projects, meaning that some types would be concentrated in Sweden while some would be concentrated in France or Austria. That is part of the decentralized organization we are striving for. It's also natural to go in this direction because in some of the companies we acquired over the past few years, there are fairly strong R&D departments, which we would like to strengthen and, at the same time, have them concentrating on what they are best in. And then they would be doing group research in certain areas."

CHART A3.2



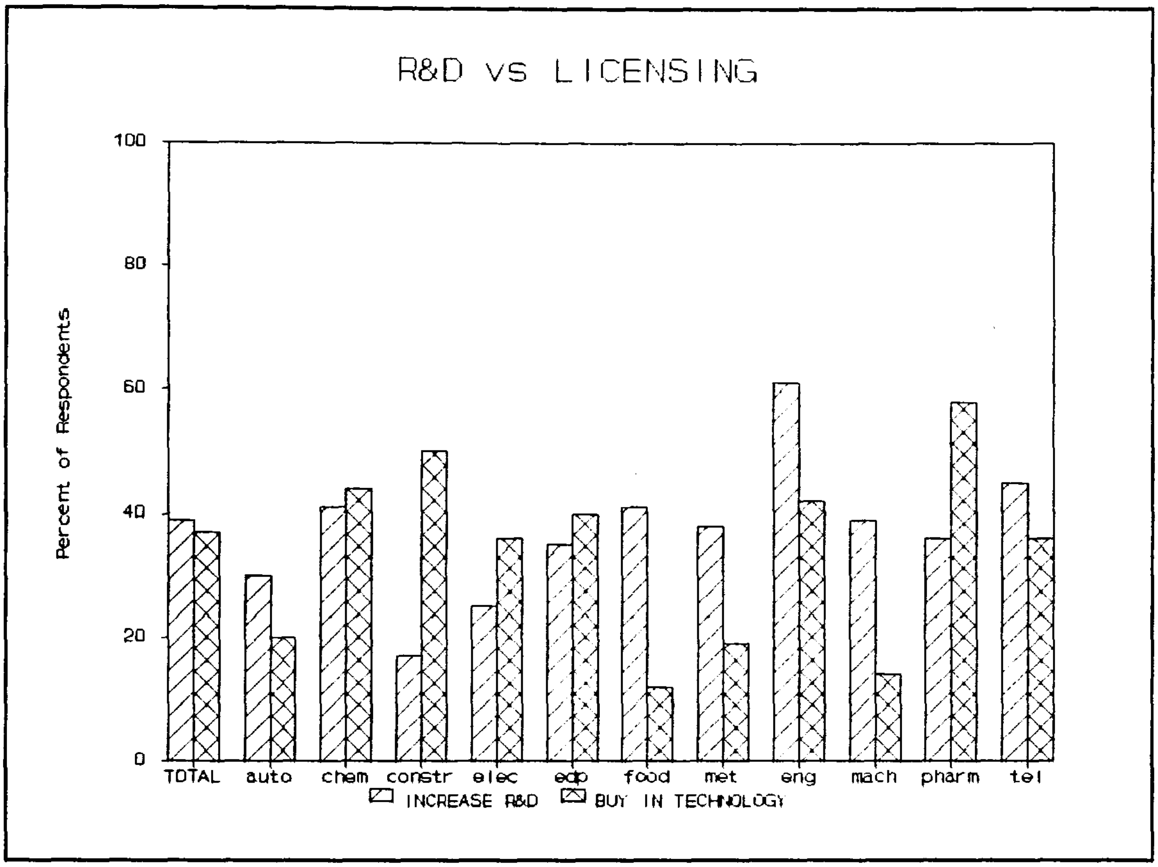
- Some U.S. multinationals are shifting more R&D responsibilities to their European operations. Says a spokesperson for a major telecoms firm: "Just as with production you want to establish yourself in the places you want to do business, so too we would like to capitalize on the very high reputation that our laboratories have in the world. So we have moved some of the R&D work associated with the units here to Europe, and there are now research facilities in the Netherlands, the U.K., Belgium and Spain. Working against that sometimes is the fact that you don't want the development work for a given product to be spread all over the place.... So yes, we expect to expand our R&D presence in Europe where it makes good sense to do so."

- A U.S. manufacturer of electric lighting: "Product development for lamps could be concentrated in one location. However, fixture design is likely to stay in the national markets for quite some time since it reflects local tastes. Although our main R&D effort in lamps has so far been located in the U.S., there is a small European team. This could be enlarged into a European R&D centre. After all, most recent developments in the lamp industry, such as halogen lamps, have come out of Europe."

Licensing

Licensing is an area not directly influenced by 1992, although such agreements of course will have to comply with EC competition rules (see B.5). But technology transfers are complementary to a company's own R&D as an essential means of staying abreast of technical development. Of those surveyed, the proportion of companies planning to emphasize licensing or buying in technology was nearly as great as those planning to increase R&D spending (Chart A3.3). In a number of sectors it was higher, particularly in construction/building materials and pharmaceuticals.

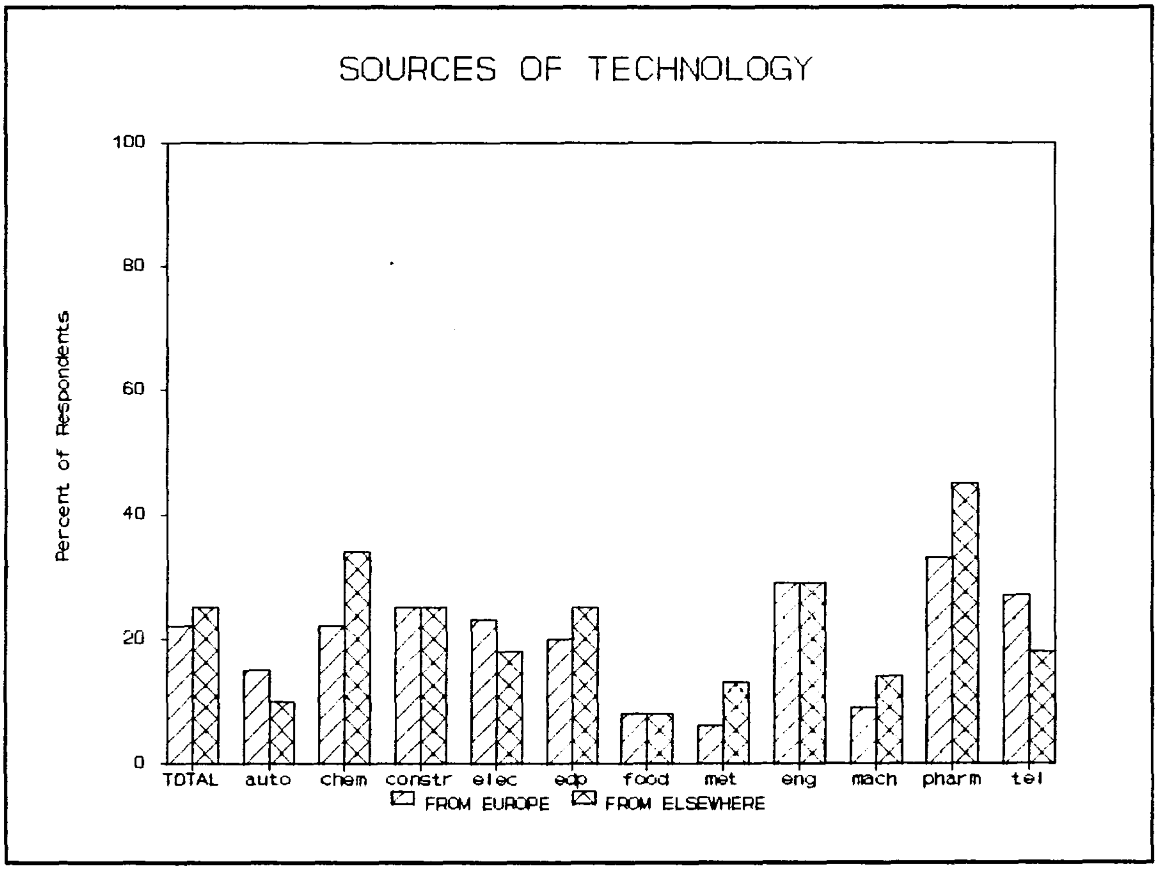
CHART A3.3



When it comes to purchasing technology, nationalism takes a back seat. As the chairman of a Spanish telecoms equipment manufacturer emphasized, the overriding concern is to get the best technology available. "We have chosen very strong foreign technology suppliers," he says, "because we must choose those that will be among the survivors 10 years from now."

According to the survey's results, EC firms show a stronger tendency to look outside Europe for potential licensors, while American companies show a slight preference for European sources. This is to be expected, given that licensing is inherently an international strategy -- companies seldom offer licenses in their own home markets. From Chart A3.4, it would appear that non-European technology enjoys a preference in chemicals and pharmaceuticals, while European technology is favoured in the auto, electrical/electronics and telecoms sectors. But these results should be viewed with caution as they may reflect the national breakdown of particular industry samples.

CHART A3.4


SOURCES OF TECHNOLOGY
Percent of Respondents
100
80
60
40
20
0
TOTAL
auto
chem
constr
elec
edp
food
met
eng
mach
pharm
tel
FROM EUROPE
FROM ELSEWHERE

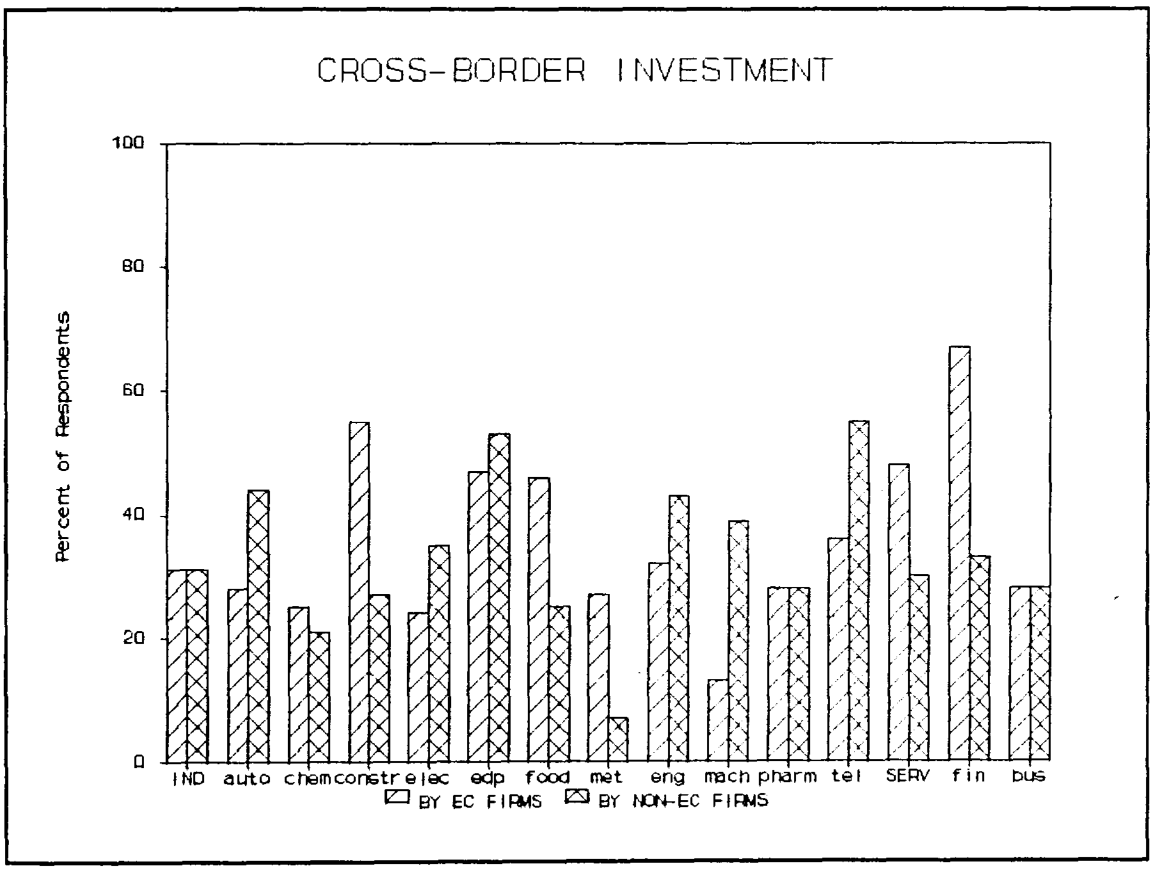
A.4 INVESTMENT INSIDE AND OUTSIDE EUROPE

The need to gear up for the larger market of the early 1990s is one factor in the current cyclical upsurge of industrial investment across Europe. Supported by a strong recovery in corporate profits, investment rose about 7 per cent in real terms last year, the highest figure for two decades.

EC companies are busily modernizing at home to ensure their future competitiveness, while expanding into neighbouring markets. EFTA firms are building up their presence within the Community -- one indicator is the recent upsurge of Scandinavian acquisitions in Denmark and Germany. Direct investment by U.S. multinationals in Europe is growing once again, mainly through reinvested profits. And Japanese and Korean companies, faced with mounting barriers against their exports, have concluded that the only way to secure access to the post-1992 EC market is through investment in the EC. Japanese direct investment in Europe reached a record $4 billion in the first half of fiscal 1988/89, up 25 per cent from a year earlier.

In the section of the survey dealing with the effects of 1992 on different industries, two questions provide data on expected patterns of investment. Respondents were asked to rate the increase in cross-border investment within the Community, and the increase in inward investment by non-EC competitors. The proportion of "strong" ratings for each of these two effects is shown in Chart A4.1.

CHART A4.1



In industry as a whole, the two effects were rated equally; in services, cross-border investment within the EC is expected to predominate. European cross-border investment is expected to rise most strongly in financial services (banking and insurance), construction and building materials, EDP and food products, while non-EC investment should be strongest in telecoms, EDP, autos and mechanical engineering.

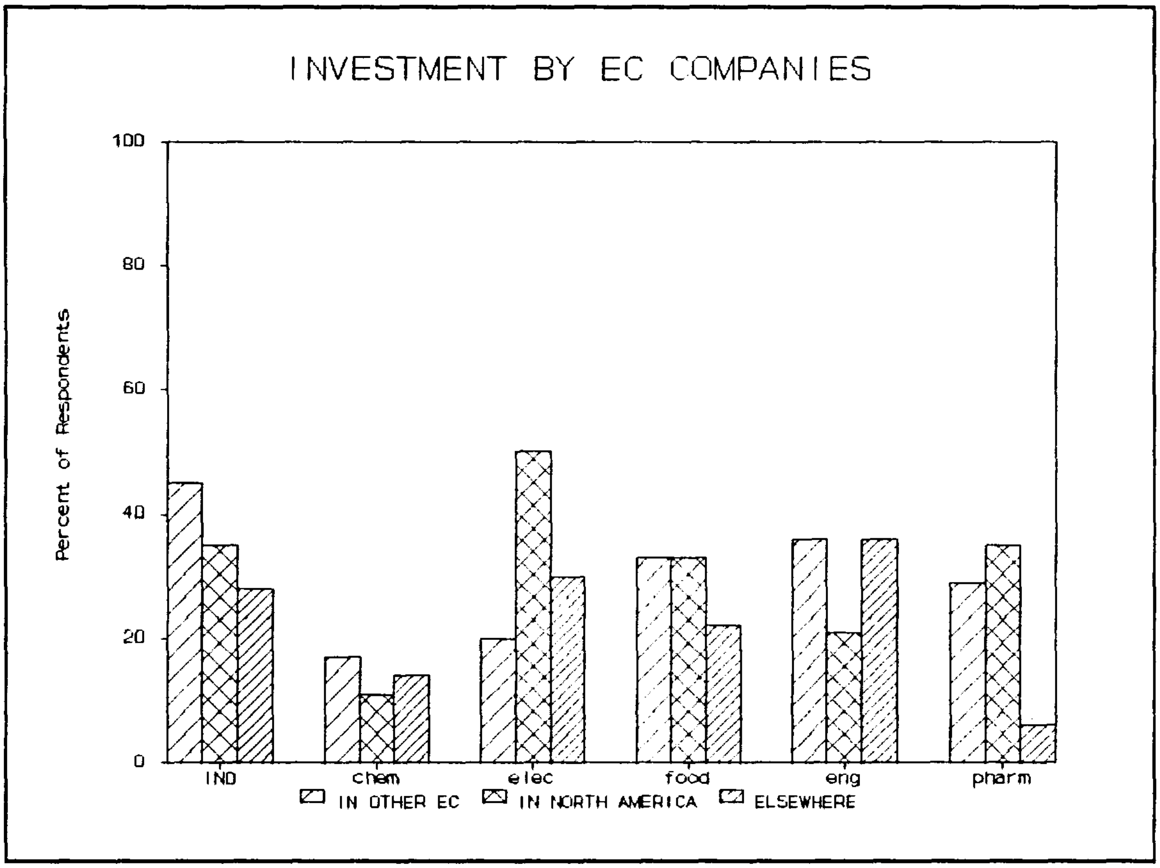
Investment by EC companies

Will large European companies react to 1992 by concentrating their investment plans in the new EC market? And will small- and medium-sized firms consider opportunities for investment in North America?

Research indicates that unification in 1992 is only one factor influencing investment decisions by large or smaller firms. When asked about their own strategies for the 1990s, 45 per cent of EC-based industrialists said their emphasis would be on increasing investment in other EC markets, but 35 per cent planned to focus on North America and 28 per cent on other non-EC markets. (Some companies specified more than one option.) As Chart A4.2 reveals, electrical/electronics firms are keener on investment opportunities in North America and elsewhere (i.e., Asia), while drug companies are also focusing on America. As a German banker observed:

> "There will be three major markets in the next 20 years: Europe, North America and Asia. North American growth will be faster than Europe's, but not as fast as Asia's. So European firms will not make the mistake of forgetting the rest of the world -- they will not want to concentrate on Europe alone."

CHART A4.2



This observation was confirmed by other interviews:

- A German automaker said that 1992 would not induce it to concentrate its own investment more on Europe. However, smaller companies (which have been investing in North America "because of the declining dollar, rather than for competitive reasons") might become more EC-oriented as they will have greater need to adapt to the new conditions after 1992.

- A spokesman for the De Benedetti group pointed out that, while De Benedetti has been "one of the biggest flag wavers in favour of the unified market here in Italy," the group's strategy has always been global. "De Benedetti has long been convinced that only companies with strong international cards to play will survive in the global markets of the future."

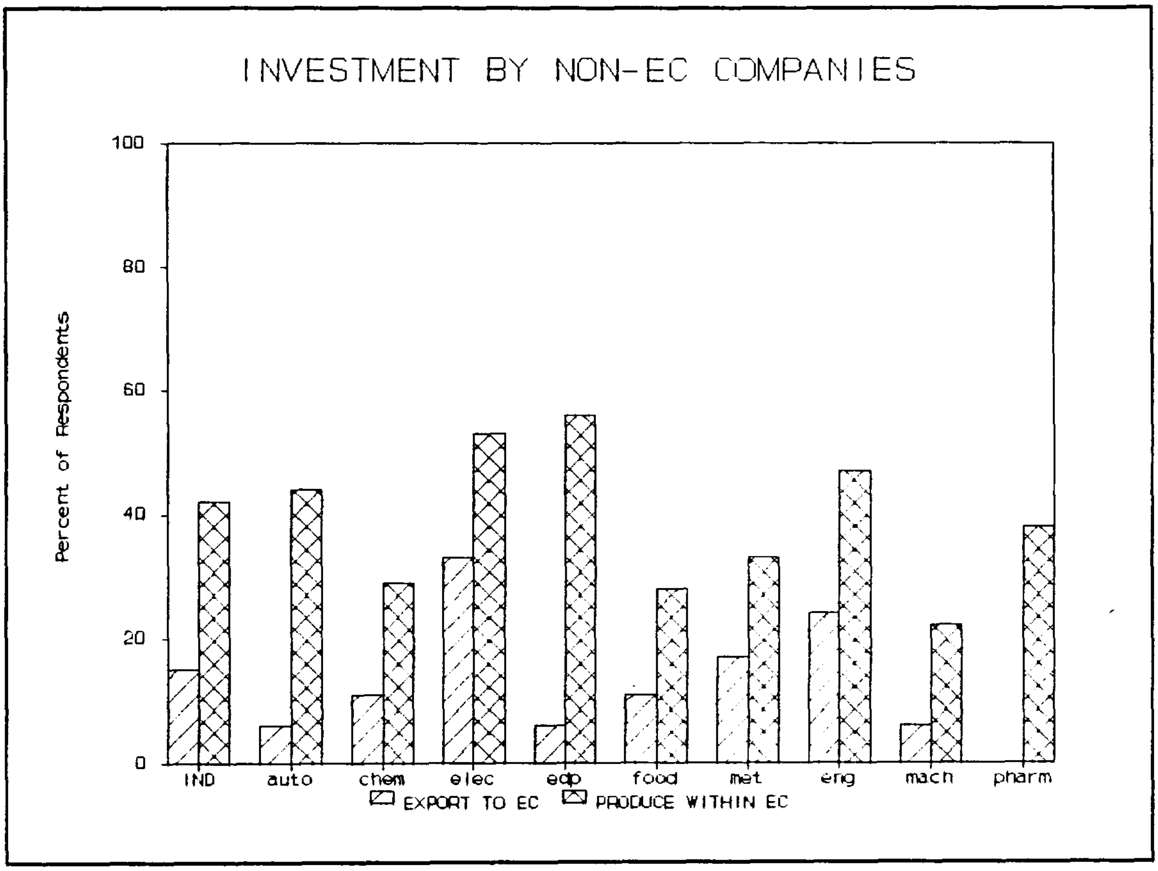
° An executive at Pirelli downplayed the importance of the Single Market: "1992 is not really all that relevant, as we have been a strong international player for a long time with manufacturing concerns spread throughout Europe almost from the beginning of the century." Moreover, the tire business today has become "a global game -- Europe is just a part of the picture."

° A venture capital specialist in Italy gave this view of cross-border forays by smaller firms: "In Italy, to ask entrepreneurs to 'think Europe' is easier said than done. When you deal with start-ups you are talking about the Italian market alone; nobody has the resources at that stage to operate on a European basis. And when you run into a company that is considering expansion, you find yourself facing Europe's high cost structure. It costs the same for an Italian company to open an office say in Germany or in the U.S., and the U.S. market offers greater potential."

Investment by non-EC firms

The survey indicates that for non-EC firms -- whether from EFTA, North America or Japan -- the emphasis will be on investing in production facilities within the Single Market rather than supplying it through exports. This emerges clearly from Chart A4.3.

CHART A4.3



A German banker, in advice aimed at EC and non-EC firms alike, stressed the need for local market presence:

"In order to know about the ongoing changes within the still national markets in Europe, within the developing European Single Market, one needs to be physically and psychologically present within this market, and not just at one point in a regional part of the uniform Single European Market."

EFTA companies are a special case, considering Europe as their home market. As compared to North American firms, they gave higher ratings not only to increasing exports to the EC but also to local production, acquisitions and alliances with EC firms. At the same time, the Swiss and Scandinavian companies interviewed are not overlooking opportunities in the rest of the world.

- Switzerland's Oerlikon-Bührle group is building up relations with North America. Under a major defence contract with the Canadian government, it is producing the Adats (anti-tank anti-aircraft) system locally and intends to use Canada as a production base when further contracts for Adats are secured elsewhere. Chief executive Michael Funk sees great opportunities for investing in the U.S. and Canada; "if the new free trade agreement actually functions," the group will set up other production facilities in Canada for the export of hi-tech products to the U.S. At the same time, it would also like to have a stronger foothold in Asia.

- At Alusuisse, an executive stressed that there will be no change in attitude toward other parts of the world as a result of 1992. "For us," he says, "the EC is one of many global markets." Alusuisse already produces chemicals in Canada and aluminum and chemicals in the U.S.

- Finland's Enso-Gutzeit is Western Europe's biggest producer of sawn goods, with around 65 per cent of group sales coming from the EC. Says the vice-president for corporate planning: "Our emphasis is very much directed toward the EC for obvious reasons: the 65 per cent explains that. On the other hand, of course, 65 per cent is a very high figure also, so we have a certain interest in balancing it with development elsewhere globally. So in the long term -- 1995 or so -- I think we will aim for approximately the same share as today."

- At Tampella, another major Finnish producer of forest products as well as machinery, the vice-president for business development denies that 1992 will cause any diversion of investment funds to Europe. "Of course you need to have some prioritizing of your efforts. It's a question of what you do first. If you look at the whole group, some business areas are extending their operations in North America, like our boiler division or the pulp and paper machinery division, and others are looking more strongly for opportunities in the EC.... It depends on the competition in the business area also. If it's stronger in the EC or stronger in North America, so we must select our strategy in that way."

- As for smaller Scandinavian companies, a Swedish executive at a multinational insurance firm offers this comment: "A lot of Swedish companies will go to Germany, that's often their first step. Then they may go to the U.K., perhaps -- they avoid the French speaking territories -- and then they go to the States. Then finally they have to go to the Latin countries."

For U.S. multinationals, 1992 has given Europe a higher investment priority, but still within the context of a global strategy. Two typical comments follow:

- A U.S. drug company: "Certainly, 1992 has an impact on our strategies. Firstly because it means dealing then with one market where we want to increase our market share, and secondly because of the importance of the EC on the world scene, because of the research, because of the level of knowledge there. It is essential to increasing our worldwide market share."

- A telecoms firm stresses the need to invest on the ground: "No telecommunications company in the world today is going to make significant sales in the future by making stuff at home and shipping it -- for a number of reasons, one of which is getting closer to the customer so you understand his needs. And for a number of reasons you want to have sizeable investments and operations in the countries you want to do business in. Our strategy is to do just that."

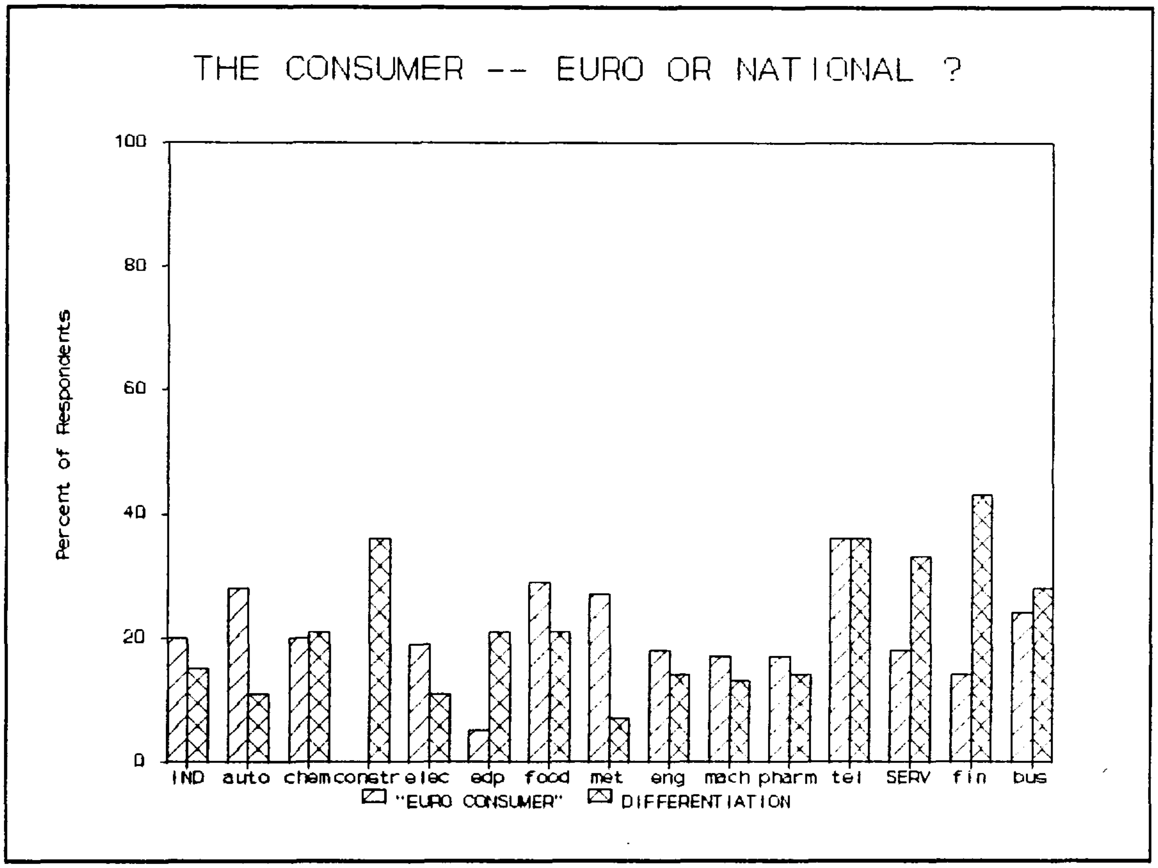
A.5 MARKETING ORGANIZATION INSIDE EUROPE

Whatever their nationality or sector, industrialists responding to the survey cited marketing and distribution as the aspects of business that will be most affected by the Single Market program. For service companies, marketing again topped the list.

Marketing strategies: pan-European versus national

A fundamental issue is the extent to which the Single Market will smooth out national differences within Europe. Looking at the implications of 1992 in terms of market changes in their sector, some executives expect a strong trend toward the emergence of a homogeneous "Euro-consumer," while others give greater weight to continuing market differentiation (Chart A5.1). The homogenizers are especially dominant in energy, metals/minerals, autos, electrical/electronics and insurance. But the emphasis on differentiation prevails strongly in construction/building materials, distribution, EDP, banking and consumer goods.

CHART A5.1



Executives interviewed for this report stressed that the Single Market will not be a uniform market in the foreseeable future:

- A German banker: "It will not be a harmonized market. Even within Germany, there is and will be a difference between the north and south, between city and country. The larger EC will still have different markets, some more attractive than others, and never really one in structure. There will be a long transition phase. There are still national preferences and traditions -- France, for example, will be different in consumer preferences than Germany."
- The German manager of U.S. market research firm A.C. Nielsen stresses that one effect of 1992 will be a greater variety of consumer products: "The product range provided by

domestic suppliers will be expanded by the influx of goods from the domestic ranges now found in other EC members. Suppliers with cross-border operations will have the advantage, but consumer demand for variety will mean that nationally oriented firms will also have opportunities. What's on the shelf now will not necessarily be there after 1992, because retailers will use modern technology in space management to maximize their allotment of shelf space, re-evaluating the articles they now carry and creating space for those that will be available after 1992."

- The European marketing manager at Lego, the Danish toymaker: "Do we have a European product? The answer is yes where Lego is concerned, but that is not the case for many more goods, not even for a number of heavily advertised ones. You may have a strong image in one or two countries for a detergent, but it may be unknown in the neighbouring country. Intense advertising, marketing and distribution adjustments may be necessary if you want to go 'European.'

  "Do we have uniform European customers? My answer is no. Differences in languages, climate, culture, average income, etc. create different preferences and buying power. The size of households is biggest in Ireland, where average income is among the lowest. The richest families you find in West Germany, but of course big differences remain between the large cities and the villages. There is a general trend toward the creation of a 'European customer,' but the trend moves very slowly."

- A medium-sized Swiss food company is working hard to overcome national barriers: "Our strategy is to invest in the product, in the market and in sales channels. We are advertising and promoting our brands at both European and international levels. We have already developed a European brand for our jam and are using pan-European advertising over Sky Channel TV."

- A major French hypermarket chain: "There is a trend toward the Euro-consumer, but it won't develop faster than until now. It will get a slight boost from the Single Market. But I don't believe that satellites and so on will hasten the arrival of the Euro-consumer.... Markets will become slightly more similar -- but the real trend is increasing market segmentation."

Segmentation is indeed the key to marketing strategy for the majority of the industrial and service companies surveyed. As Chart A5.2 shows, the general trend is to focus on market niches, most often at the pan-European rather than national level -- although the latter prevails in construction and financial services.

<u>Pan-European distributors</u>

As illustrated by the comments on M&A in the distribution sector (see A.2), there are mixed views on the extent to which national wholesalers and retailers will be extending their operations across the EC market. In fact, the small sample of distribution firms covered by the survey was split evenly between those aiming at pan-European or national market niches. Some views on this issue:

- Lego of Denmark: "Is there a European retail trade? Again, the answer is no. There are examples of chain stores which are strong in one country, semi-strong in one more, but then most of the chains lose in power in country three. I think only very specialized kinds of shops will be able to form all-Europe-embracing chains, and then with a rather limited number of shops per country. The reason is, that if you try to run a full-fledged supermarket chain you will for years to come still run into such great differences as to consumers' preferred goods and brands, that it becomes too chaotic and costly."

- A.C. Nielsen: "Retailers will become more powerful as they continue to expand across national borders, especially toward France, Spain and Italy, later also to Portugal and Greece. There will be Euro-managers in retail organizations which will buy across borders; their ability to get better conditions and discounts will be strengthened through purchasing associations. And as their distribution networks expand, EC-wide retailers will gradually begin to launch Euro-brands. There is a real threat that stronger, EC-wide operating retailers will try to force down consumer prices to a common low level."

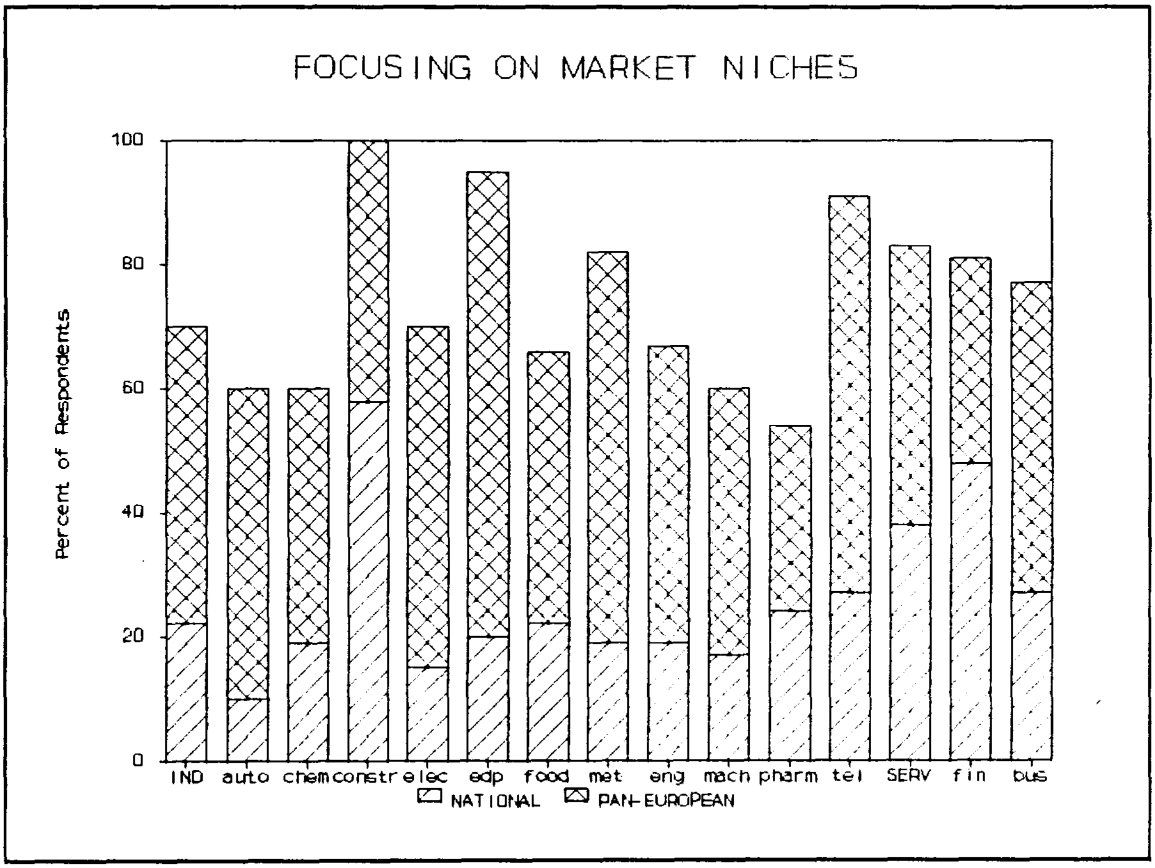
° A U.S. lamp manufacturer: "The lighting industry primarily sells through wholesalers; for us these account for 60 per cent of sales. There is a lot of concentration going on at this level. In France, for example, the number of wholesalers has dropped considerably as companies merge, acquire other national firms, etc. Also, French wholesalers are now acquiring U.K. firms. In future, there will be fewer and bigger wholesalers doing business in three or four EC countries rather than only in their national markets.

"Distributors at the retail level -- supermarkets or furniture chains -- are also concentrating. There is more co-operative buying, and not only at the national level. In future, co-operative buying associations will cover more than one country.

"Altogether, this means buying power will be concentrated in fewer places, thus generating more competition and more pressure on prices."

° A Swiss food company: "Europe-wide purchasing will develop over time. Companies will come to us and say, 'We buy from you in Germany, the U.K. and Holland; how are you going to compensate us?' This will mean negotiations at corporate level to determine prices, year-end bonuses, sales conditions, extra services, etc."

CHART A5.2



In fact, cross-border concentration in retailing has already begun. Aldi, the leading and most aggressive German food discounter, has branched out into Denmark, Belgium, Holland, France and most recently the U.K. Tengelmann, the German supermarket chain that owns A&P in the U.S. and Canada, has expanded into the Netherlands through its share in the Hermans Group and plans to be active in Spain and Portugal. Schlecker, an expanding German family-owned chain of low-priced household goods, wants to move into France and the U.K.

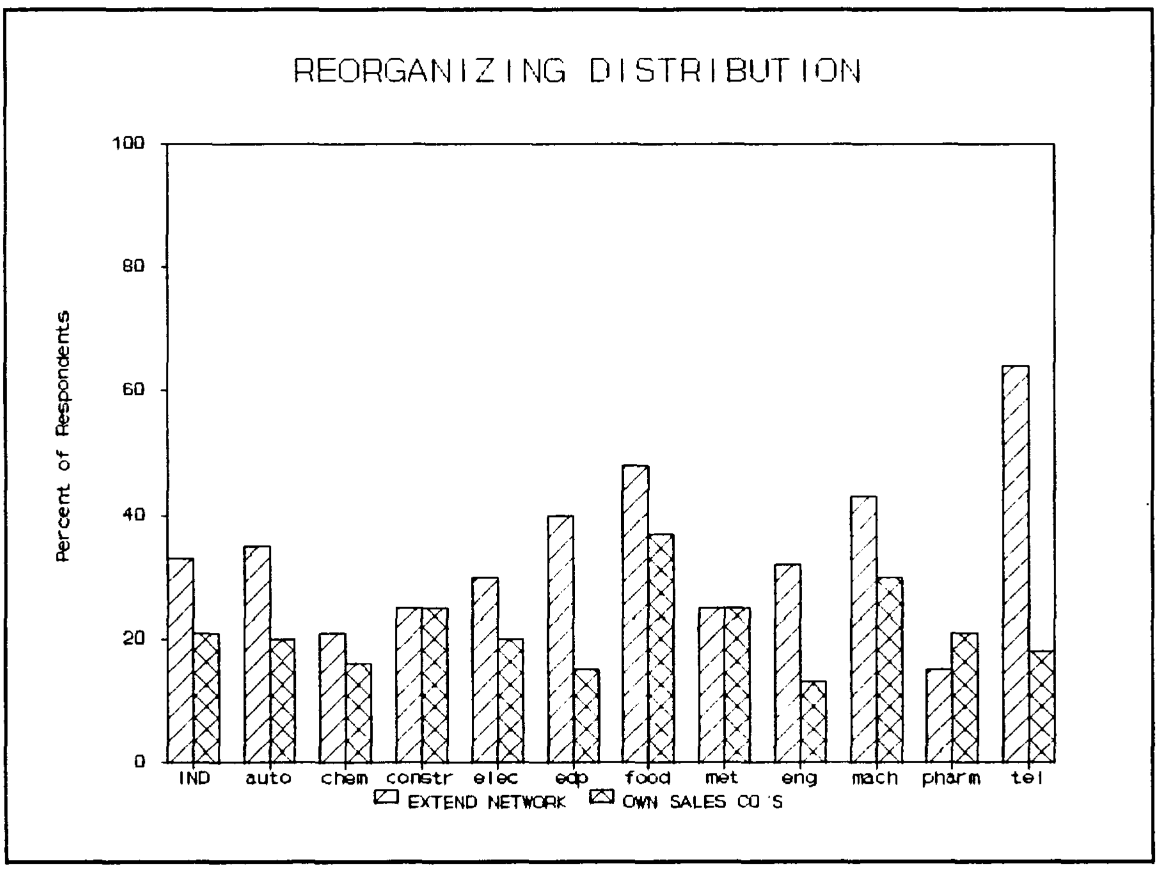
French retail giants such as Carrefour are also on the move into EFTA as well as EC countries, with a preference for the south. Also on the transborder expansion course is Belgium's GB-Inno-BM group, which is targeting Italy, France and the U.K. (see A.2). And plans for EC internationalization of the mail order business are being made by La Redoute in France, and Quelle and Otto in Germany.

Strengthening distribution networks

For manufacturing companies, pan-European distribution networks will be a key competitive weapon in the post-1992 era, as barriers and costs of transborder shipping come down. Those that do not already have a well-established network are scrambling to create one. In the auto industry, for example, Japanese firms like Nissan and Honda are working hard to build dealer networks in hitherto closed markets such as Italy and Spain, while Fiat has launched a crash program to add 150 new dealers in Western Europe during 1989.

As shown in Chart A5.3, the drive is on in many sectors to extend distribution networks -- especially in telecoms, food, machinery and EDP. Some firms are also moving to replace independent distributors with their own sales companies, although only in the pharmaceutical industry is this the dominant trend.

CHART A5.3



Some examples of reorganizing distribution systems follow:

- A German auto firm: "There will be fewer distribution levels. The way from the factory to the customer will be shorter. With the Single Market, firms will not need national distributors."

- A Swiss food company: "So far we are only doing EC manufacturing in Italy, Spain and Holland but not in the U.K. or Germany. We use agency agreements with importers in those countries where we don't have manufacturing facilities. We could buy or set up sales companies in these countries and do the importing and distribution ourselves. However, we have no plans to do so as yet.... Distribution channels will also change as direct sales are made to distributors in other EC countries rather than through an importer."

- A U.S. manufacturer of building fixtures, which sells exclusively to wholesalers: "We see the wholesalers playing a major part in the development of 1992. They will do it first across country boundaries. For example, there's a very powerful guy in France, on the Côte d'Azur, and it's no problem for him to run into Italy. And in the Aachen area, you've got a concentration of Holland, Belgium and Germany and they don't care where they buy the product from, so I think you'll find that wholesalers near the border will be much more aware of the different prices....

  "What we are doing is looking to help our customers by giving them a chance to spread on a pan-European basis. We've actually done this several times already, taking a customer who's interested in one country and helping him to move into another. We think by doing that -- because we've got a lot to offer in knowledge -- he will be loyal to us. Whether he will, I don't know."

Centralizing control of marketing

The Single Market will create strong pressures to co-ordinate marketing and streamline physical distribution. More than half the industrial respondents to the survey planned to tighten control of marketing and service operations, with the strongest emphasis in the auto, EDP and metals/minerals sectors (Chart A5.4).

Reorganization of marketing was a live issue at several firms interviewed as part of this study of the effects of unification:

- A Japanese trading company: "The thing we are thinking about is our restructuring, because in the European area we have many branches and many offices, and after the Single Market is built we have to think about the efficiency of our network. Because, for example, we have one branch in Brussels, one in Düsseldorf, one in London and one in Paris...."

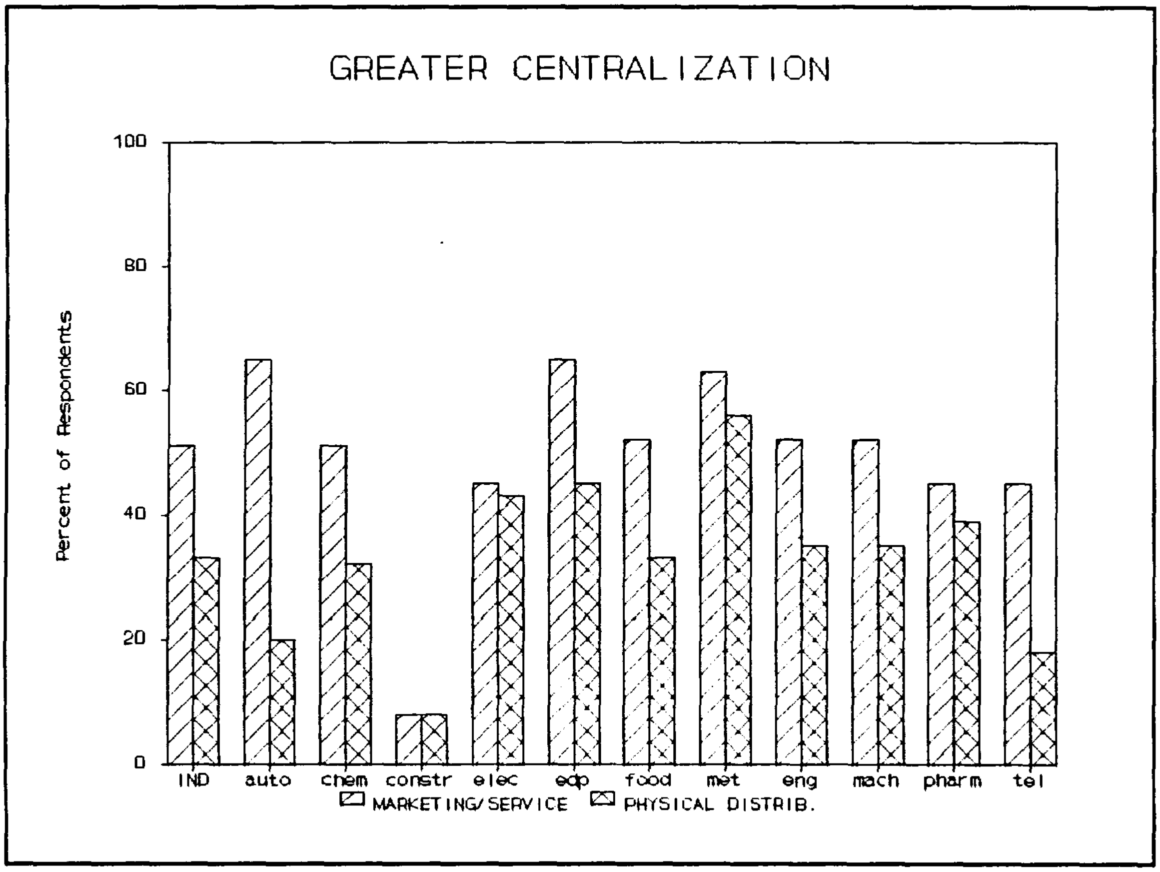
- A German auto firm: "Marketing will still be different nationally -- marketing must be local. But you won't need warehousing and sales offices in each country. Our distributors in all major markets are wholly owned subsidiaries; this will not change. Only the distribution system will change, including warehousing of parts. Administration will be recentralized, doing less in the individual countries."

- A U.S. building materials supplier: "Ultimately there may be management changes, as we may need cross-border salesmen to suit circumstances. If products move across boundaries we'll need to reorganize reporting and management -- and this may happen sooner than the rest."

- The Swedish paper and packaging firm, ASSI: "Marketing of packaging paper to corrugated-box companies is still done on a country-to-country basis, except for some warehousing facilities which serve more than one country. We actually made an experiment of having marketing people hold responsibility for more than one country -- a few individuals -- and then we withdrew that because it didn't work very well. You know there are a lot of small cultural differences, which make it imperative to be as local as possible. To have a marketing man in Hamburg go marketing paper in Holland -- that's not a good idea today....

  "I think it takes a long time before you can create regional sales offices irrespective of national borders -- a very much longer time than I expected when we ran that experiment 10 years ago."

CHART A5.4



The Lego executive quoted earlier, though skeptical about the future of cross-border retail chains, has noticed that

> "European chains of different origin do co-operate in one sense -- on information. A kind of jungle drum system means that you cannot as a producer offer one type of conditions to a chain in one country and another type in another. You will have to offer the same conditions in Paris, Hamburg, Copenhagen or wherever."

An Italian chemical industry consultant makes a similar point:

> "There will be changes on the distribution side. Because sooner or later distributors will be increasingly free to pick up products throughout the market, and companies will therefore have to start developing 'European' price and general sales terms policies."

A U.S. lighting manufacturer expects that the trend toward cross-border concentration at the wholesale and retail levels will have organizational implications for suppliers:

> "Because of these changes in the distribution channels for our industry, we will have to market our products differently. We will be using pan-European marketing, advertising, launching of new products....
>
> "In addition, the setting up of an EC-wide pricing system will mean that pricing and other decisions will be centralized at the European headquarters rather than left to country managers. We may also centralize some sales functions at the European headquarters. For example, it would make sense to conduct the big sales to big customers -- that is, lamp sales to manufacturers of OEM fixtures -- from headquarters."

In the computer industry, marketing strategy is determined somewhat differently than for other sectors, as a U.S. manufacturer explains:

> "There are certain things you can only afford to do once. For instance your basic hardware family is set by world-wide strategy: for this type of major investment, firms can't afford regional differences. Selling to customers then has to fit customer usage and this determines differentiation. For example, we look at various European industries to see where we can be most successful. Finally, there is a software differential in application areas when you are working on a solution for a particular industry and market niche....
>
> "Our distribution strategies will change as European markets are freed. As transportation is liberalized, overnight delivery services like Federal Express can develop in Europe, more sophisticated and cheaper telecommunications will become possible across national borders, etc. This means that distribution will become more centralized, less localized, but we can still maintain high-level responsiveness to customers for delivery....
>
> "Margin pressures will force the company to reorganize internally, recentralizing certain functions and purchasing goods and services more cheaply through better outside procurement or subcontracting. For example, it is possible that an outside company could contract to supply all physical services for us -- warehousing, deliveries and so on -- with its own truck fleet, storage facilities, etc."

Centralizing physical distribution

As suggested in the last comment, logistics is another area that will undergo major changes as a result of 1992. A third of all industrial companies surveyed indicated that they plan to centralize physical distribution, with the highest response coming from metals and minerals firms (Chart A5.4).

Deregulation of transportation will bring considerable changes, including lower costs. At first the benefits will not be completely realized because suppliers will have to come up with new production and warehouse locations -- as most of them are already trying to do.

Which cities are likely to be strengthened as distribution centres for the Single Market? From the interviews, the odds-on favourites appear to be the major Dutch centres (Amsterdam, Schiphol, Rotterdam). The Netherlands is a natural choice for distribution because of its central location, major sea and airports, and strong local trucking industry.

The U.S. multinational 3M, for example, has developed a European distribution plan "to ensure that 3M and its customers gain full advantage from the eventual removal of internal frontiers and other barriers to trade." It will invest over $3 million in electronic order management systems to link its customers throughout Europe with 3M supply sources to speed up delivery times. As to physical distribution, the company's U.K. general manager explains:

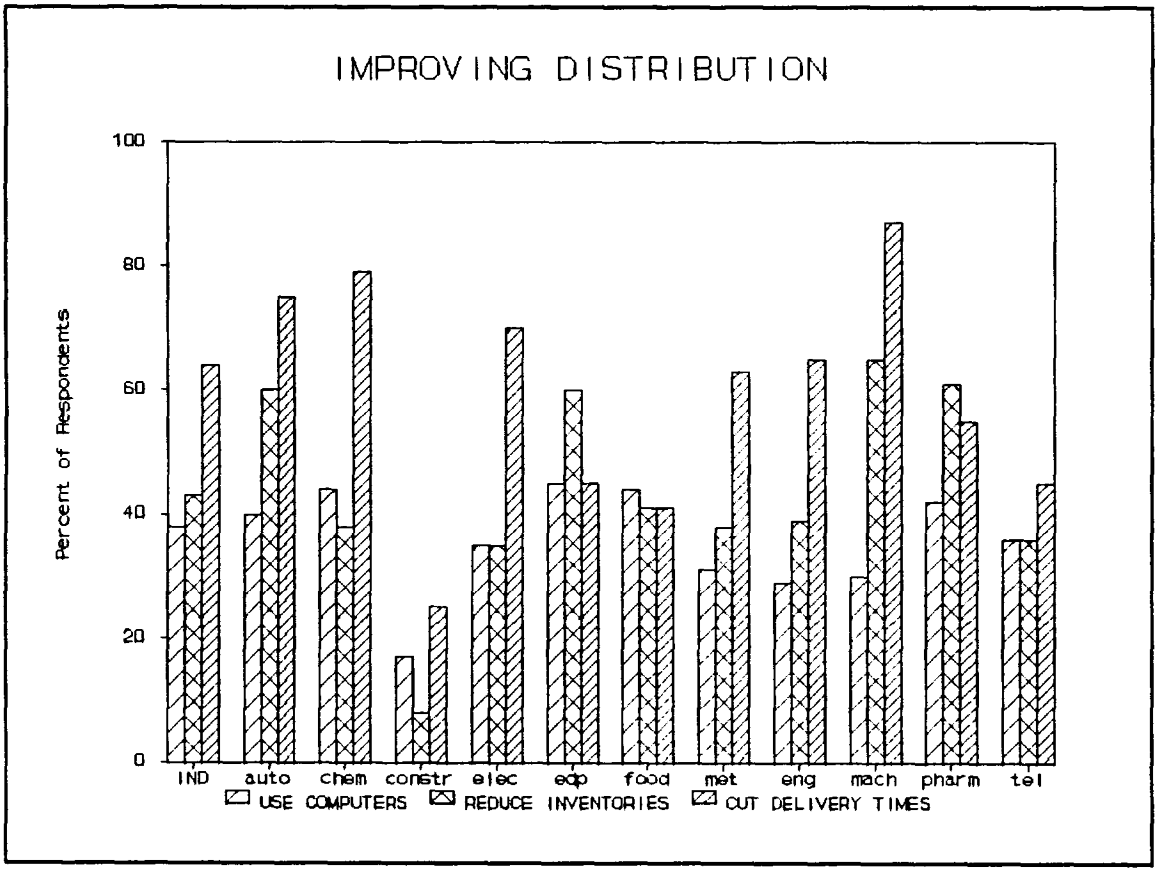
> "3M has a central distribution centre in Holland for goods not made by 3M in Europe. This centre also acts as a distribution point for commodities which cannot be delivered economically to individual countries direct from supply plants in Europe. By 1992 we will reduce our overall European inventory ratio by one third by making greater use of this central distribution capability, by more rapid stock replenishments throughout Europe and by increased direct cross-border deliveries to our customers." For example, 3M can deliver orders direct from Holland to the Paris area within 24 hours.
>
> "We are also challenging the need for country-based warehousing. Shared safety stocks and facilities are now becoming far more feasible and acceptable to our subsidiary management teams.
>
> "A transportation task force is now studying our total Europe haulage requirements given these changes in distribution patterns and the proposed liberalization of trucking services in Europe."

But the Netherlands is not the only choice. The Danish toymaker Lego, for example, foresees that "the wholesale level will more or less disappear, and a number of big central inventories be set up at strategic places, as for instance in Cologne to serve part of Germany and the Benelux." And the U.S. lighting manufacturer sees other possibilities:

> "Fewer customers will help lower distribution costs. We will be able to save on transport, administration and warehousing. We might concentrate our warehousing. In Spain, we now have several, one each in the main cities. In the U.K., we dispatch all over the country from one warehouse. But eventually we might be able to supply Spain from France once customs borders disappear."

The objectives of efforts to overhaul distribution systems, whether through computerization or centralized warehousing, are to reduce costs and speed up deliveries. These aims are reflected in Chart A5.5. Overall, 38 per cent of the industrial firms surveyed plan to use computer networks to track selling patterns; 43 per cent aim to reduce inventories in the distribution system; and 64 per cent hope to reduce delivery times and improve responsiveness to customers.

CHART A5.5



A.6 PROPENSITY TO EXPORT AND IMPORT

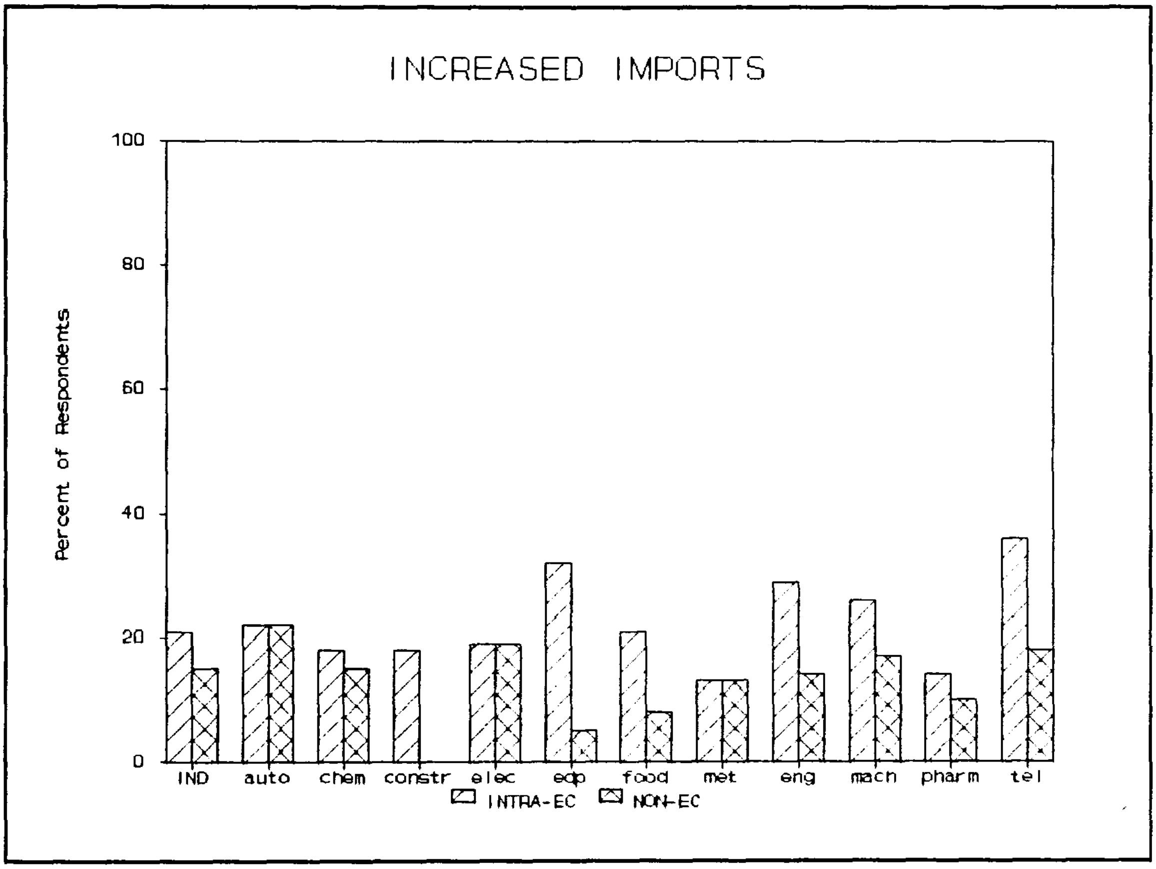
Will the larger size of the domestic market make EC companies more introverted? Or will the stronger companies sustained by that same market be more formidable competitors overseas?

Import and export patterns

Several questions in the survey shed light on this issue. Asked about the impact of 1992 on intra-EC trade in their sector, 21 per cent of industrialists predicted a strong and 48 per cent a moderate increase. The highest ratings were in telecoms and EDP.

In Chart A6.1 these results are compared to those for increased competition from non-EC imports. Not surprisingly, growth in intra-EC trade is expected to be stronger in general, but in three sectors (automotive, electrical/electronics and metals/minerals) the increases in EC and non-EC imports are rated equally.

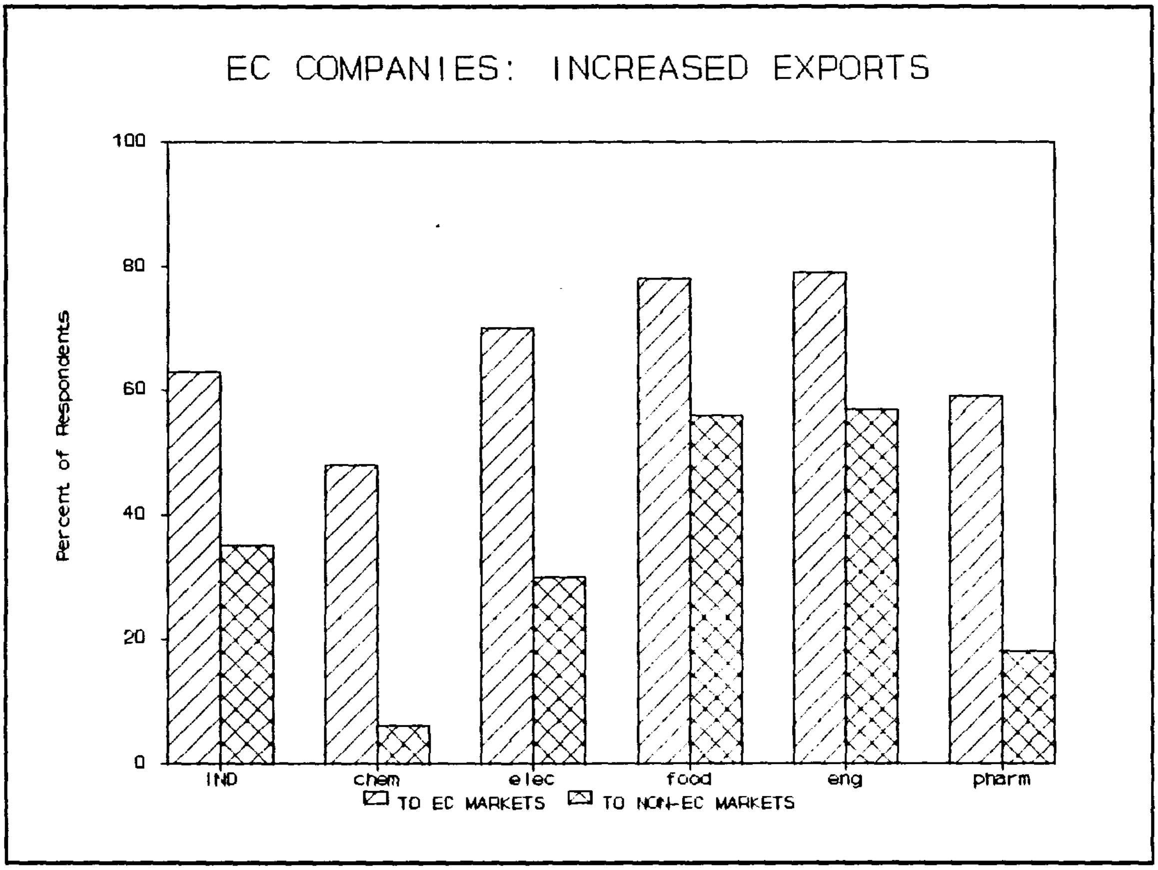
CHART A6.1



On the export side, when EC companies were asked about their own plans for the coming years, nearly two thirds stressed increased sales to other EC markets while one third emphasized exports to the rest of the world. In chemicals, pharmaceuticals and electrical/electronics, the bias toward intra-EC sales was particularly marked (Chart A6.2).

However, it should be noted that global competition today must be measured not just in commercial trade but also in investment flows. As pointed out earlier (see A.4), increased competition from non-EC firms is expected to come primarily through direct investment in Europe rather than imports, while the number of EC companies planning to emphasize investment in North America and elsewhere outweighs those stressing cross-border investment within the Community.

CHART A6.2



Purchasing patterns

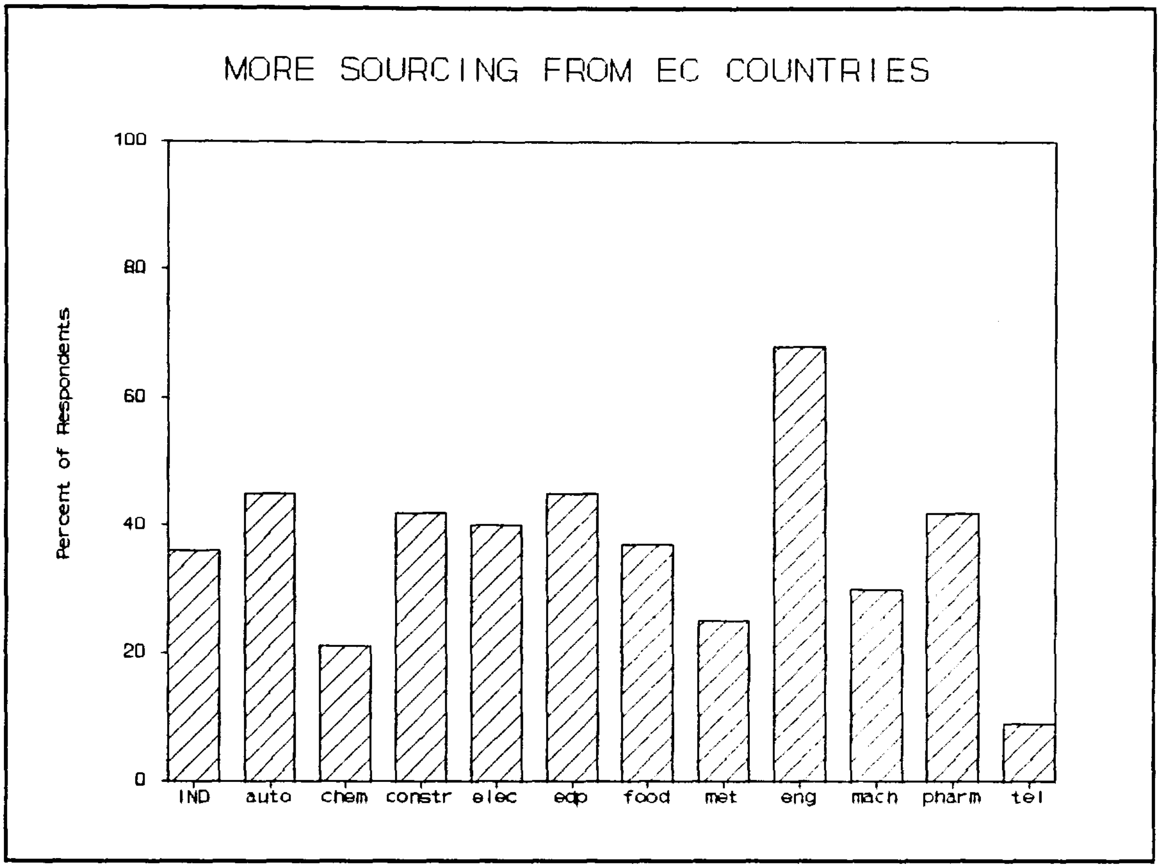
Will the purchasing patterns of European companies change in favour of procurement from other Member States at the expense of imports?

Overall, 36 per cent of the industrialists surveyed indicated that their own companies will put a strong emphasis on sourcing from other EC countries. Mechanical engineering stands out with a 68 per cent rating, while telecoms is at the other extreme with a surprisingly low 9 per cent (Chart A6.3).

The business impact survey reveals a keen interest in reducing in-factory inventory holdings, e.g., through JIT (just in time) inventory management, especially in the mechanical engineering, machinery, EDP and auto sectors. This development will lead to new supplier relationships based on close proximity, good communications and compatible information systems (hardware and software). Similarly, the growing sophistication of production techniques, with computer-integrated systems solutions requiring close co-operation with the customer, will encourage a greater regionalization of suppliers.

Increased competition within customer industries is already affecting their suppliers. Thus Ford and other automakers have reduced the number of suppliers or subcontractors they work with but now have working agreements covering several years with their remaining suppliers. The former customer-supplier relationship is giving way gradually to a form of partnership. In power equipment, ABB's big German subsidiary has shifted some components purchases abroad in a general restructuring of sourcing to lower-cost EC countries such as Italy, Spain and Portugal.

CHART A6.3



In the interviews, some executives stressed that their companies would maintain an even-handed procurement policy, motivated by strictly commercial or sometimes broader strategic considerations:

- A major French hypermarket firm: "For us, removal of customs barriers will have no impact whatever. Possibly a minor one -- fewer customs inspectors and border guards. But removal of technical barriers will be a major plus: we can buy abroad more easily....

  "Yes, we will do more sourcing from EC countries. For instance, tariffs on Spanish imports will be eliminated by 1992, and we can already see that we will be sourcing more from Spain as that happens.... But we will certainly import more from non-European countries as well. Our discount stores chain is already purchasing worldwide."

- A German automaker: "Although we do not manufacture in Canada, we buy some supplies there because it is company policy to buy in all countries where we sell. A company goal is to expand all purchasing in the dollar area, first because of the exchange rate and second to keep a balance in sourcing. So we will buy more from Canada, but not because of 1992."

On the other hand, several executives expressed concern over EC policies that could restrict their ability to buy abroad. An Italian aerospace company speculated that sourcing from non-EC countries could become increasingly difficult: "Our greatest concern is with respect to the U.S., where we have several important suppliers." And in the electronics industry, the U.K.'s Amstrad, which has built its success on contracting out manufacturing to Korea and elsewhere, has begun to shift its sourcing from Asia to the U.K. and other European countries as a result of EC antidumping pressure.

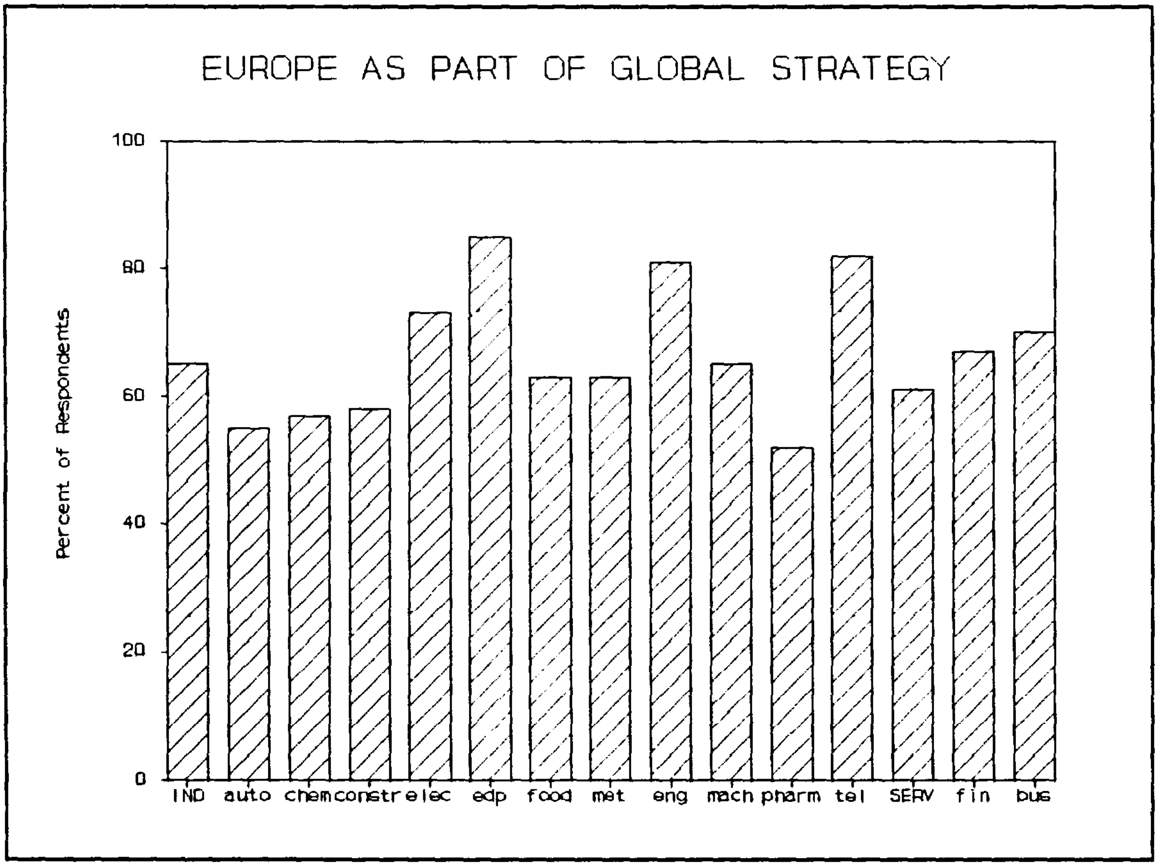
EC firms as global competitors

A fundamental aim of the 1992 program is to develop European industries that can face their U.S./Japanese rivals in global competition, thanks to the economies of scale -- in research, production and distribution -- made possible by an enlarged home market comparable in size to theirs.

The impact of 1992 on EC firms' costs and competitiveness will be discussed in more detail in section A.7. As to their mental attitude -- whether more introverted or outward-looking -- the impression from this study is that the latter will predominate.

Indeed, one of the most striking results of the survey is the high proportion of companies that see Europe as part of a global strategy -- over 60 per cent overall in both industry and services, and over 80 per cent in EDP, mechanical engineering and telecoms (Chart A6.4).

CHART A6.4



This global mindset came through again and again in the corporate interviews conducted for this study, as illustrated by citations in earlier sections. Of course, "globalization" of markets and competition is a fashionable catch-phrase today, and some observers predict that 1992 will refocus businesspersons' attention toward more parochial concerns. A Danish banker expressed this (minority) view:

> "Companies will be so occupied -- both mentally and financially -- with the improving possibilities in the internal market, that for a number of years they will let their efforts on outside markets stagnate."

Against this can be cited the forthright statement of an executive at a large German metals and minerals company:

> "If I were a Canadian, I wouldn't be so worried about 1992. This company won't become introverted. We have a worldwide business; we are not in a narrow European market. Europe is not the limit of our investments."

A.7 COSTS AND COMPETITIVENESS

To what extent do firms expect the Single Market to improve their cost structures and their European/global competitiveness? Where will these advantages come through (greater production scale, lower distribution costs, cheaper imported components, etc.)? And what will be the effect on competition and profit margins in formerly insulated national markets?

One company that is looking forward eagerly to 1992 is the German chemical giant, Bayer. Its European co-ordinator, Friedrich-Wilhelm Pohlenz, has stated:

> "For a long time we have been fully established in the EC, not only for sales but also for production. Our production sites are so well distributed over the EC that there is no basic need for us to adapt because of 1992. The exception is Spain, where we are building up to export to other EC countries....
>
> "What the Single Market means for us, in the foreground, is cost reduction through unified norms and more competition in services -- e.g., banking, insurance and transportation -- that will mean more business opportunities. The growth effect may not be as much as now claimed, but every one percentage point in growth will mean a better overall situation. So we expect growth -- and cost reduction. And we will have considerably more competition. That should be good."

Cost savings

Discussion of potential cost savings stemming from the Single Market usually starts with the removal of frontier controls.

In one of the studies published by the EC Commission in 1988 under the general title *Research on the Cost of Non-Europe: Basic Findings*, it was estimated that the cost to firms of customs compliance in intra-EC trade amounts on average to 1.5 per cent of the value of shipments, divided about 50/50 between exporter and importer. This comprises internal administrative costs (including staff, computers and overheads), agents' fees, delay-related costs, excessive inventories, etc. The study found that costs per consignment were 30 to 45 per cent higher for small and medium firms than for large multinationals. Lifting the barriers should therefore offer them proportionally greater benefits.

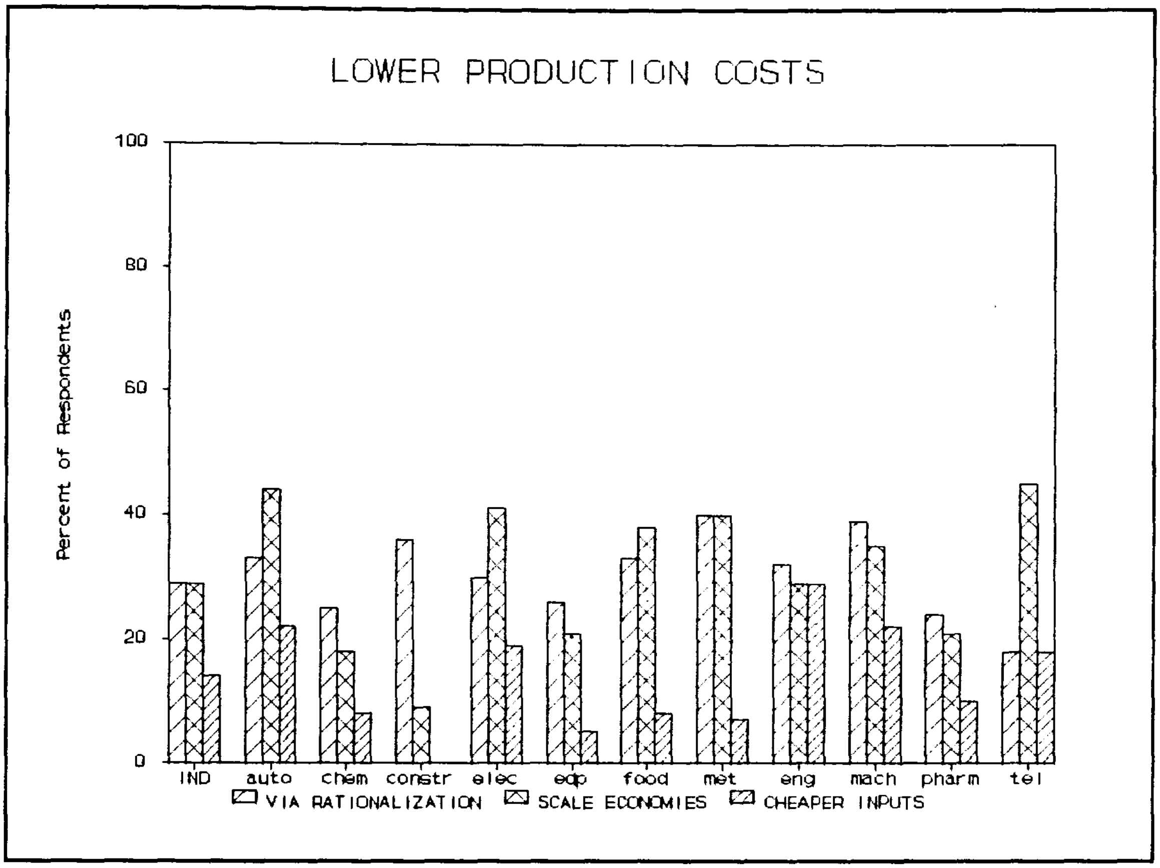
Although relatively small as a proportion of total value of shipments, these costs may be a major consideration where profit margins are low. Moreover, border delays and uncertainties are becoming increasingly problematical as JIT management of components supply gains in importance.

For the participants in the business impact survey -- mostly large firms already well-accustomed to coping with border paperwork -- the removal of intra-EC customs frontiers is not all that mouth-watering. As a major positive impact of 1992, industrialists ranked this behind the removal of technical barriers, creation of common EC standards, liberalization of financial services and free movement of capital. Wholesale and retail distributors are understandably the most interested in this aspect of the internal market agenda -- but also the most skeptical that it will be achieved by 1992.

For industrialists, significant cost savings are expected to come from a variety of sources (Charts A7.1-2): lower production costs, resulting from rationalization and economies of scale, distribution costs, transport costs, financing costs and access to cheaper inputs. As always, the weightings vary considerably from one sector to another.

Rationalization. Mounting pressures on profit margins will oblige firms to do everything they can to ensure healthy long-term profits. As discussed in section A.1, companies will be taking steps to concentrate and specialize production in different plants, close down some facilities, streamline their product range, and generally cut costs and raise productivity. Sectors that expect significant savings from rationalization include metals/minerals, machinery, construction/building materials, food and mechanical engineering.

CHART A7.1



Economies of scale are the prime consideration for auto, electronics, food and especially telecoms companies. As one U.S. telecoms equipment supplier explained:

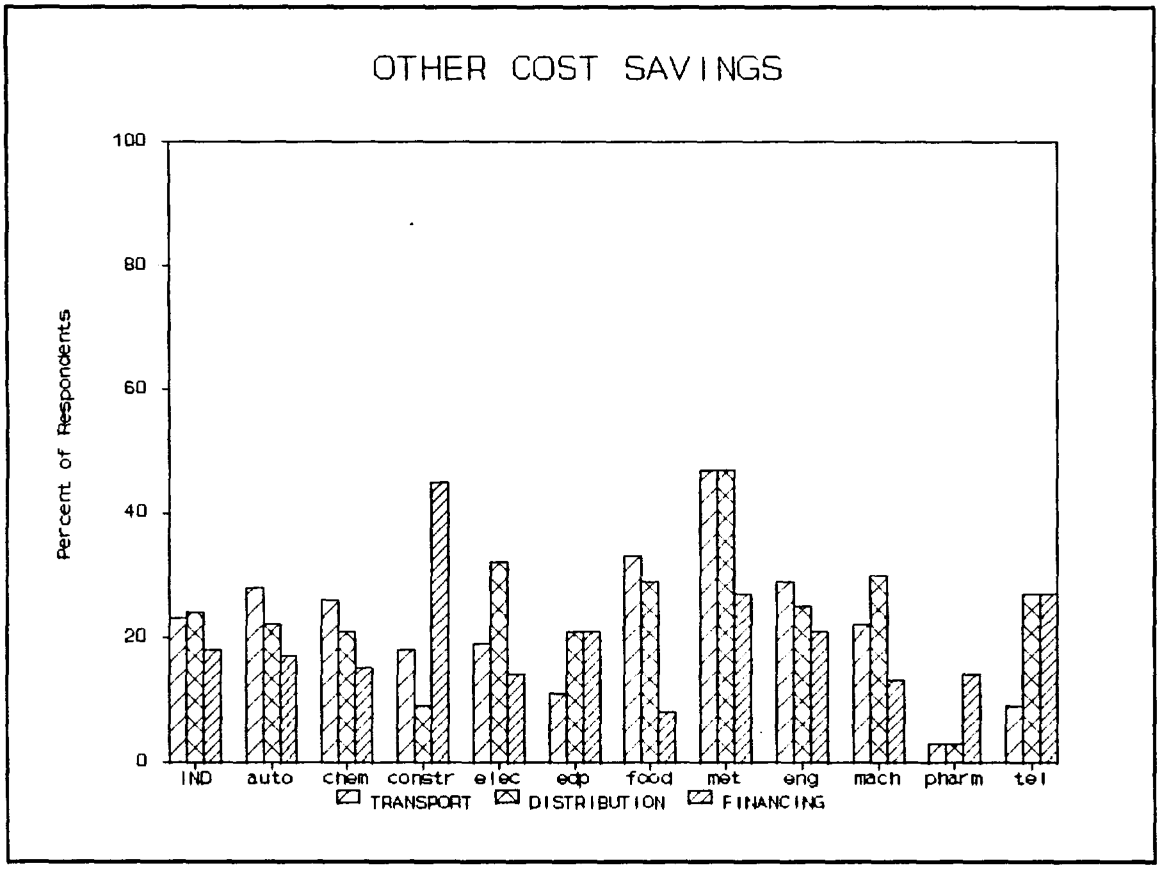
> "For us the biggest cost reduction will be in reducing the amount of product adaptation necessary in each country today and the costs associated with that. This will happen in two ways. Firstly, there will be common standards for new products and services so that one should be able to design them pretty much on a regional basis. Secondly, the process of type approval -- you'll be able to test the electrical safety of a business telephone, say, in one country and have those tests accepted in others. This will result in not having to pay for laboratories to do the tests two, three or more times. We'll also be able to move products into the market faster -- and that's money too."

Access to cheaper inputs is of particular interest for mechanical engineering and machinery firms, less so for those in EDP, metals, or food processing (the EC being anything but a low-cost source of agricultural produce). But even in this sector there is something to play for, as explained by a medium-sized Swiss food company:

> "As a company buying agricultural products, we cannot centralize purchasing or use just-in-time supplies. Seasonal fruit and vegetable production means that we buy when the goods are available. We contract for farmers' crops and never know what per-acre yields and tonnage will be: that depends on the weather....

> "However, for the other half of our purchasing -- glass bottles and jars, labels, packing boxes -- we are making progress. Eventually, we should be able to buy from one rather than 10 suppliers; we are already using Europe-wide purchasing from one supplier for the aluminum lids on individual portions. And increasing our critical mass in purchasing means we will pay less for our packaging and bottles."

CHART A7.2



Lower transport and distribution costs are a key factor for metals and minerals companies, and in general for those with heavy or bulky products. The interviews produced a number of examples of the costly delays that shippers hope will be eliminated after 1992. An EC Commission official pointed out that, because of border delays, it takes five days for a truck to travel from Denmark to Portugal (a distance of 2 500 km), compared to only three days across the U.S. (5 000 km); he puts the aggregate cost of frontier delays at $15 billion per year. Other complaints from industrialists:

- Germany's Bayer contracts out all its long-haul transportation. "Today, trucks that come fully loaded from Portugal must return empty because foreign carriers are limited as to what they can carry inside Germany. If these restrictions are eliminated, as planned, that would be a better use of transportation and fewer trucks would be needed."

- A U.S. building supplies manufacturer: "I would think we have $100 million a year moving around Europe today -- at cost value, not sales price value. Now that, hopefully, will go at a cheaper rate. But what do we save: maybe 1 per cent. I think perhaps more important, it might get there faster, and that would be important to us because it's reducing the lead times on the products."

- A U.K. manufacturer of heavy machinery is less sanguine. "1992 is a non-event in my eyes. Of a thousand and one existing obstacles to cross-border trade, maybe 11 or 21 will be removed under the Single Market program. This hardly represents a bright new dawn....

  "Take shipping for example. When we ship a piece of machinery from Belgium to, say, Italy, we have to wait around 24 hours at the French frontier. Filling out 30 customs documents is not the main delay factor. More problematical is having to get permission from dozens of local officials within France for scheduling the shipment of heavy or wide loads on their particular stretch of highway. They control the exact hour of passage. Each of these bureaucrats is a petty king in his territory."

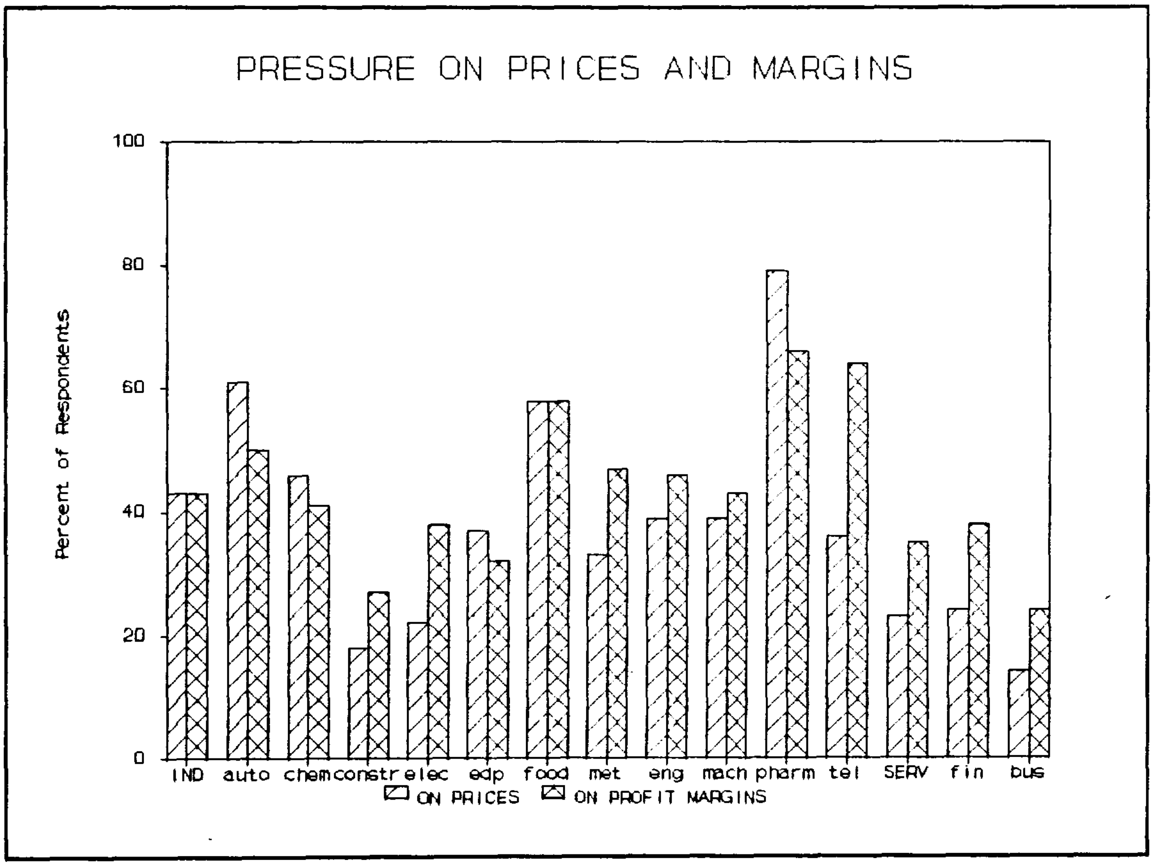
Lower financing costs are the principal concern for construction firms, but of general interest to all sectors. As an EC official sees it, cost reductions will be limited: "Interest rates won't drop -- banks' profit margins are very small, often 0.1 per cent on international transactions. We will have a bigger and better supply of financial services, but not cheaper." Even so, many businesspersons expect to benefit from the liberalization of banking services (see B.12). Says a U.S. computer maker:

> "Rather than depend on two or three big local banks in each country, we will be able to use one or two banks across several countries. Financing will thus become easier and less costly."

Prices and profitability

The removal of internal market barriers and the increase in competition are widely expected to lead to a downward convergence of national price levels, with consequent pressure on profit margins. As shown in Chart A7.3, this price convergence is expected to have a particularly strong impact on pharmaceuticals, autos and food products. Price convergence should be less important in telecoms, but the profit squeeze is expected to be nonetheless severe. By contrast, construction and business services will remain relatively sheltered.

CHART A7.3



As a Swiss executive observes, "It is consumers and not companies that will benefit from lower costs due to rationalization and standardization. Why? Because all companies will be rationalizing, and all companies will have to pass on their cost reductions through pricing to consumers." A Finnish businessman agrees that profit margins will shrink, in the short and medium term at least:

"In the long term, one can only hope that the situation will improve. Take any industry in the world, and you can see that deregulation (and 1992 is a deregulation process) has always lowered profits. Which is quite natural, because otherwise it would be contrary to what everybody says -- that the EC is a good thing, in other words that prices for the customer, for the consumer, will go down. So I think that's quite logical."

The following are some illustrations from different sectors:

- A German auto maker: "All signs point to more competition. There will be reduced profit margins, especially in markets that have been closed up to now. There will be more opportunities in markets, but through increased competition. So there will be no chance to realize great profits."

- A Japanese trading firm agrees: "I think the supply of cars will be much higher in the future than the actual demand in the EC area. That means the price will be reduced dramatically. Fiat and Peugeot, for example, are now keen on investing in their own factories to raise competitiveness, and on the other hand some of the Japanese companies are thinking about establishing in the EC and then exporting products made here to Japan."

- Market researchers A.C. Nielsen have made a detailed study of price differences for detergents and body care articles. For the latter, they found the highest prices in France and Denmark and the cheapest in Greece and Portugal; surprisingly, however, prices in Spain and Ireland were close to the top levels.

  Says the company's German managing director: "These price differences will not plunge to an EC-wide minimum level on January 1st, 1993. In Germany, there will be a period of adjustment lasting six to eight years. Our initial analyses have shown that price pressure on German manufacturers will most likely not be very important -- rather the opposite, because German producers will have greatly increased market chances within Europe."

  He warns, however, that "consumer goods manufacturers will be under greater pressure for the EC as a whole than at the national level to decide between the alternative strategies of market leadership based on product quality or price. Suppliers must consider those two broad strategies in terms of each of their brands and examine the consequences of concrete measures for their products, e.g., changing the marketing mix."

- In the pharmaceutical industry, price differences from one country to another are huge. A study by the Economists Advisory Group, taking the U.K. price level as 100, puts the average level in Germany at 164, in France at 76 and in Italy at only 57.

  The French manager of one U.S. drug firm sees major price adjustments coming, but not all downward: "I think the Single Market will encourage companies to manufacture in those EC countries where prices are higher and export to the lower-price countries like France, rather than vice-versa. Thus pressure will build on the authorities in France to raise prices more toward the European level.

  "But harmonization will also exert downward pressure, as all EC governments are trying to save money on their health systems. I think this price leveling will come fast -- within three to five years, not ten to fifteen. But one consolation is that parallel imports will fade out as price differentials narrow."

- A U.S. lighting manufacturer: "Customers [i.e., wholesalers] will be able to shop EC-wide and will have fewer problems bringing Italian goods into France. We therefore have to look at European pricing differentials and set up an EC-wide system. There is bound to be a convergence of national price levels, with prices moving to the lower end of the present European scale in our industry. Thus pressure will increase on our profit margins."

- A U.S. computer maker sees two answers to the impending price squeeze: "The first is to fight price erosion through product differentiation. The second is to reposition the company in our present markets, exploit our present market strengths or look for new markets. Here we would be using a specific industry focus -- say automobiles, chemicals, electronics -- and making investments to uphold our positions in these sectors."

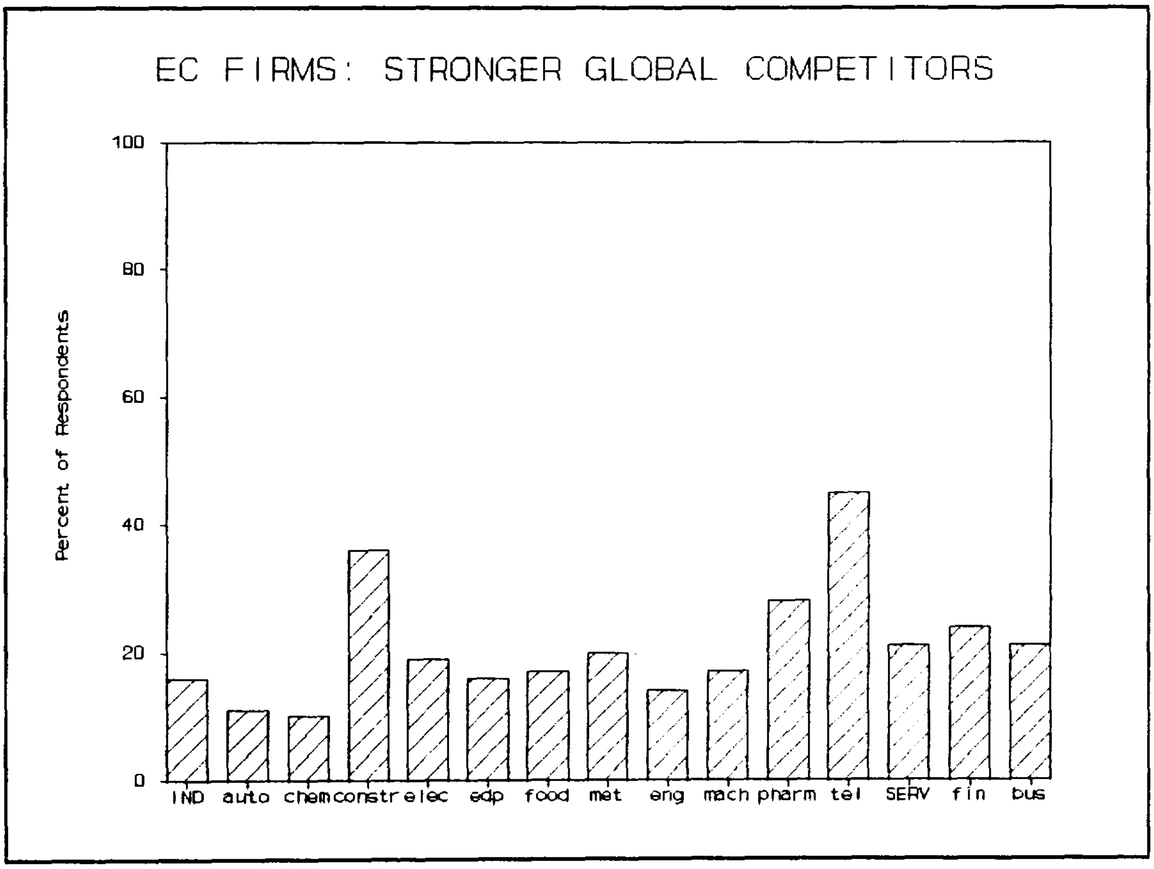
- A German banker: "In banking there will be smaller profit margins, especially where there is now little competition. That could mean 20 per cent less in Spain and Italy; in the U.K. and Germany, 7 to 10 per cent less for already narrow margins. In general, margins will be reduced for all sectors of finance. So there will be efforts to maintain profits through larger sales, especially in insurance, where there has been less competition up to now."

- Finally, a French hypermarket chain gives the retailer's viewpoint: "Convergence of national price levels is inevitable; this will be a rather strong impact of the Single Market. This will be very positive in France, where producer prices are considerably higher, especially in big-ticket items like cars and consumer electronics.... Pressure on profit margins? Not for French distributors, for us they are already really low. The U.K. is the only country where they are relatively high -- but that might change."

International competitiveness

Interestingly, only 16 per cent of industrial respondents and 21 per cent of service companies surveyed felt the 1992 program would have a strong effect in terms of strengthening EC firms as competitors in third markets. A larger number (41 per cent and 24 per cent respectively) thought this impact would be moderate. Only telecommunications and construction companies showed much higher levels of confidence (Chart A7.4).

CHART A7.4



By contrast, the executives who were interviewed for the study were generally more positive. Two examples:

- A German banker: "Yes, that must be the result of firms' success in an increasingly competitive Europe. Firms that will be weak in the EC would be weak outside it, too.

My answer is always the same: the feeling that 'only the EC is important and let's forget the rest of the world,' cannot be the result of the Single Market. The EC is not enough."

° A corporate planner at Olivetti: "In the information industry, European producers are today much better placed to fight Asian and American competitors than they were in the past. The system of so-called national champions, where each country had its favoured information technology company -- favoured in its own market, but weak everywhere else -- is rapidly coming to an end.

"At present the degree of penetration of information technology in the European market is substantially lower than in North America. This means there is more room for growth over here. American producers will fill some of the space; the Europeans, because of their better understanding of their own markets, a larger part of it.

"The trend under way toward the unification of the European market will further stimulate growth in the information technology market here. This trend, by its nature, favours producers who can work globally, in a multilingual, multicultural environment -- something Europeans are good at."

B. EFFECTS ON EUROPEAN GOVERNMENT POLICIES

B.1 EXTERNAL TRADE

The drive to establish a coherent external trade policy has brought Brussels up against some of the deepest contradictions in the European Community. Theoretically the EC Commission has had jurisdiction over Community trade policy for the last 20 years; but in reality trade in manufactures and commodities is still regulated by a web of national restrictions, ranging from quotas on textiles and bananas to national licensing rules on strategic exports.

The task of forging a coherent trade policy will also cover services, where internal market initiatives to open up public procurement markets, to introduce a single banking licence and to dismantle the barriers to Community-wide insurance services will entail major new benefits -- and fierce competition.

Indeed, according to one EC official, completion of the EC's Single Market will require nothing less than "a complete remodeling of the Community's existing external policies and the creation of policies where they do not yet exist."

Will reciprocity evolve into protectionism?

EC Commission president Jacques Delors has repeatedly labeled as absurd third-country concerns that the Community's plans for the completion of its Single Market in 1992 will be accompanied by protectionist measures that will lead to the creation of Fortress Europe. "We are the world's largest trading power, and its most open market," he points out, "and we will remain so."

Nevertheless the Commission's attempts to portray the post-1992 EC as "Partnership Europe" have been put into question by its repeated calls for reciprocity in market access or for preserving the balance of advantages in the GATT.

Former EC Trade Commissioner Willy DeClercq has argued that the EC's external policies will continue to evolve, since they are based in part on legislative proposals still to come which will regulate the internal market. As a result, the Community "cannot now answer all the questions concerning the impact of 1992 on its trading partners." Moreover, he explained that external policies will vary from sector to sector and even from product to product as new Single Market legislation materializes. DeClercq stressed that the EC's document is at least partially directed at Eurocrats, setting forth basic principles to guide them in drafting legislative proposals. In this way the external implications would be taken into account and examined at the earliest stages of the legislative process.

It is important to stress, however, that so far there has been no concrete evidence of increased protectionism by the Community in the manufacturing or service industries -- apart from Brussels' aggressive use of the antidumping weapon (see "Community trade instruments" below). Agriculture is of course a different matter, with the long-established protectionist structure of the Common Agricultural Policy.

Attitude to GATT trade negotiations ...

The Community is fully committed to the Uruguay Round of multilateral trade negotiations. It is perhaps most interested in finding a modus vivendi with the other farm exporting countries on agriculture, but it is also eager to win international rules for the service industries and intellectual property protection. The EC will go along with accompanying moves toward tariff reductions, provided there are interesting counteroffers from countries like Japan.

For the EC, however, the importance of the Uruguay Round lies more in forging market access guarantees than in reducing tariffs. The Community would like its moves toward building a Single Market in the financial and investment services to be followed by improved access to other world markets, notably in the newly industrialized countries. In areas such as public procurement, where the EC's proposals go further toward open tendering procedures than existing GATT rules, the Community will also be seeking reciprocal access.

In both cases calls for reciprocity are viewed by most Member States as only a bargaining chip in the GATT talks. The Commission has suggested that, where reciprocal access cannot be negotiated multilaterally, it will take the bilateral route. But Member States have already indicated their reluctance to allow the Commission much authority in this field.

It is a coincidence that the EC's 1992 efforts coincide with the Uruguay Round negotiations, but the latter will probably play an important role not only in ensuring that the Single Market initiative will be implemented in a way that is consistent with the EC's international obligations, but also in providing a forum in which to address sensitive issues. Even without the Uruguay Round, however, it is clear that GATT members will have a much easier time with the post-1992 Community due to the organization's general principles of most-favoured-nation status and national treatment.

... and the GATT code on public procurement

The Community is discussing proposals which would extend existing directives on the liberalization of public procurement to the hitherto excluded sectors -- energy, water, transport and telecommunications. The Commission text would permit Member States to favour European tenders over non-EC offers to a limited extent (see B.10), a preference that could be eliminated if the GATT public procurement code were extended to include these sectors. During the last review of the code, however, the EC refused to go along with such extensions, pointing out that first it had to deregulate these sectors internally.

It remains unlikely that the EC will agree to such an extension in the near future. Not only does the Commission have a major battle on its hands to get its proposals on intra-European liberalization through the Council of Ministers, but the EC will probably want a few years of experience with the results of these measures before setting out on GATT negotiations.

The fate of Article 115

Article 115 of the Treaty of Rome allows Member States to reintroduce controls on specific products coming from other Member States provided these goods are subject to national quantitative restrictions (QRs) on non-EC imports, most of which date from pre-Community days. Article 115 is invoked when a government believes that third-country exporters are shipping through other Member States in order to circumvent its national quotas.

High on the Commission's list of priority actions lies the development of a common import policy in preparation for when the removal of intra-EC border controls makes Article 115 protection inoperable.

Most of the existing national QRs are imposed on products coming from Eastern Europe and Japan. In 1987 they covered a total of 736 tariff positions representing 4 per cent of total EC imports. Spain and Italy operate the most quotas, with respectively 33 per cent and 24 per cent of the total, followed by France with 8 per cent, Benelux and Germany with 6 per cent each, and the U.K., Greece and Denmark with 3 per cent each.

A common import policy will be needed after 1992 to prevent Member States from introducing measures that border on the illegal in an attempt to protect sectors that will no longer be shielded by national quotas operated under Article 115. As one EC official commented, "Elimination of existing QRs will not eliminate the economic need for them." Pressure to revamp these restrictions is also coming from Japan, which has made clear to the Commission that it will complain to the GATT about these illegal QRs if the Community does not start phasing them out.

The Commission envisions three different sets of products requiring different solutions when Article 115 action becomes obsolete:

- Many national quotas will be simply eliminated because the domestic industry is no longer threatened. Typical examples include photographic film, leather gloves, motors, car tires and toys.
- In other cases the introduction of an EC-wide sectoral policy, including subsidies or possibly a more liberal use of the safeguard or dumping instruments, will permit elimination of the national quotas. Products in this category include automobiles, textiles and fresh bananas.
- In the most sensitive areas, the introduction of Community restrictions may be necessary before Member States let go of their national protection. Shoes, radios, televisions and sewing machines fall into this category.

While working toward these various solutions, the Commission has meanwhile made it much more difficult for Member States to win Article 115 protection.

Community trade instruments

The Community's various trade instruments -- the safeguard clause, the "new commercial policy instrument" (NIPC) on unfair trade practices, and above all the antidumping rules -- will take on much more importance in the absence of Article 115 protection. Not only may Member States insist on wider and more flexible interpretation of the dumping rules, but the French have started pushing for a reinforcement of the NIPC, and the safeguard clause may suddenly be in greater demand.

The French have also put forward the idea that priority in applying trade instruments should be granted to complaints filed by sectors that have become more vulnerable as a result of uniform EC trade policy.

Safeguard clause: This instrument, based on the GATT's Article 19, permits countries to take action against imports merely as a result of the quantities involved. However, it cannot be applied selectively to major exporters, and it also requires compensation to all affected exporters. As a result this instrument is hardly ever used. In the post-1992 EC, however, Member States may insist on its use, if only to elicit assurances from third countries that they will not concentrate their exports on any one Member State.

The NIPC: The French have started the push for reinforcing the NIPC, claiming that it has been a total failure in achieving rapid solutions to cases of unfair competition in third countries such as counterfeiting, market exclusions, etc. In September 1988 commissioner DeClercq rejected the need for a reinforcement, but this attitude could change in the new Commission.

Antidumping: The EC has been very successful in applying its antidumping tool as a selective safeguard measure. Although the near future will not see any spectacular policy innovations on the scale of the component dumping rules introduced in June 1987, Brussels' antidumping services will not be idle. Now that most Japanese electronic products are subject to duties, and Japanese manufacturers are scrambling to comply with local content requirements introduced in the component dumping regulation, the Commission is convinced more than ever of the importance of the dumping instrument as one of the Community's most effective weapons of commercial/industrial policy.

The EC has recently reinforced its dumping rules, but officials deny that this "has anything to do with 1992." Private trade experts agree, and point out that what the EC will need in the post-1992 world is a major increase in personnel to process the complaints. The reforms introduced in July 1988 include requiring importers to pass on the dumping duties to the final consumer so that prices on the imported goods do go up.

In the coming years there will undoubtedly be new target countries. Clearly Taiwan and Korea are already under the Commission's spotlight. And if the East-bloc export drive does materialize, according to one Brussels expert, "You can expect some funny pricing levels as East European managers are allowed to experiment with free trade." However, he points out: "When all the Commission was interested in was Japan, due to that country's sales and distribution setups, the EC only needed a dumping instrument to find built-in dumping margins.... But this is not so true with these newer countries." If a reinforcement of other Community instruments is needed, "the path toward a more dynamic and aggressive use of these instruments will be slow."

In addition to new target countries, the Commission may also strive to apply dumping to the services sector. Under its transport legislation, the Commission has decided to condemn the Korean shipping company, Hyundai, for underpricing freight rates on the Europe-Australia route. The Council of Ministers endorsed the Commission's proposal in January 1989, imposing "redressive" duties of 26 per cent.

This decision could lead to similar complaints in other service sectors, notably Japanese banking operations. But Commission officials say this would require a totally new dumping regulation, because the current one can only be applied to manufactured goods. Although such a new regulation is possible, this may prove to be an area where the Commission will have to look at other instruments to deal with real or perceived unfair trading practices. An agreement on services in the Uruguay Round could also help in finding solutions to the Community's fears about service dumping.

Local content/origin rules

In the run-up to 1992 and beyond, the spotlight will shine increasingly on local content and rules of origin, with pressure building for local content to play a bigger and bigger role in determining origin. Tightening of local content requirements is viewed as necessary for securing a European manufacturing base in some sectors, and assuring that the benefits of 1992 go at least in the first place to European companies, products and investments.

The prime motivation behind these moves comes from the proliferation of Japanese investments in Europe, which are sometimes perceived as simple "screwdriver" operations set up either to avoid dumping duties (in consumer electronics) or to circumvent other restraints on direct exports from Japan (cars).

Thus far the Community has made little use of local content to determine origin. In the early 1970s it imposed a 45 per cent local content requirement on television sets in order to benefit from the European label. In the early 1980s the EC-Japanese arrangement on video cassette recorders introduced a de facto 45 per cent local content requirement for EC-made Japanese VCRs to fall outside the European import quota on Japanese-origin VCRs. More recently with its component dumping legislation the Community ruled that in order to avoid paying duties, a Japanese investment had to represent a minimum 40 per cent European content measured at the factory gate, meaning that only "hard" components would be taken into consideration.

In general, however, the Community adheres to the internationally accepted rule (set out in the Kyoto Customs Convention of 1965) that origin is determined not by local content levels but by the location where "the last substantial process" is performed. But veteran trade experts believe that one recent decision involving semiconductors suggests that Brussels may be moving toward defining origin as "the *most* substantial process" regardless of when it takes place.

The production of semiconductors involves three basic stages: the manufacture of a wafer or disc of about 15 cm (6 in.) in diameter; the printing of 30 to 40 semiconductor circuits on the wafer (known as diffusion); and finally the cutting of the wafer into individual chips. Until now this last cutting process has determined origin.

In early 1989, however -- following concerted lobbying by European industry -- EC customs experts agreed that to benefit from Community origin, the diffusion operation must now be carried out in the EC, while the last cutting stage may be done abroad. This means that European chip producers who want to benefit from low wage costs in third countries for carrying out the last assembly or cutting stage can still benefit from Community origin. On the other hand Japanese producers who do the cutting or assembly operation in the EC, but the printing elsewhere, will not benefit from Community origin.

The impetus for this change came from problems Philips had in shipping television sets into France due to that country's national quotas on non-EC televisions. The Philips sets incorporated chips cut in Singapore, which meant that the chips could not be taken into account when calculating EC local content. As a result Philips started the campaign to modify the EC origin rules, but since then trade experts explain that "the move took on a life of its own."

Although the decision is highly technical, it could be of major importance to many sectors if the Community extends the move toward "most substantial" process. For the semiconductor industry, the new ruling will push investments into the EC, especially if the pending dumping investigation of Japanese semiconductor exports goes against them.

In a similar local content/origin case, the Commission is expected to reject U.S. certificates of origin on Ricoh photocopiers assembled in California. EC experts argue that 90 per cent of the photocopier components are Japanese, and the U.S. origin claim is just another attempt by the Japanese to sidestep the 20 per cent dumping duties on photocopiers exported directly from Japan.

Local content and inward investment

Local content rules are usually used to ensure that inward investments benefiting from national subsidies do bring to the local economy a certain level of technology transfer and employment. What goes into local content can vary widely, however, from parts alone to public relations campaigns, depending on the Member State.

As a result, two major sectors -- consumer electronics and automobiles -- have been lobbying for several years for a tighter definition. While the European Consumer Electronics Association came out in 1985 in favour of a 60 per cent local content requirement in its sector, the European automotive industry is pushing for 80 per cent. The French government has applied this ratio unilaterally in counting U.K.-assembled Nissan models against the Japanese firm's French quota.

The automotive sector argues that the 80 per cent level would ensure that a company would have to carry out some of its R&D and produce some of its "noble parts" (engines and transmissions) in Europe. In this way the investment would be clearly contributing to the economic wealth of Europe, and not just taking advantage of the large EC market.

Despite this pressure, it is unlikely Member States will agree in the near future to any harmonized local content rules -- either globally or by sector. The Commission's failure thus far to adopt a European automotive strategy indicates that even within the Commission vast disagreement exists concerning the introduction of an 80 per cent requirement.

What is possible however is that Member States will agree to respect certain guidelines regarding the granting of aid to foreign investors. In this way at least investors already in the Community would not be obliged to compete with newcomers who can benefit from investment subsidies without meeting high standards of local content.

Failing an agreement among Member States regarding subsidies, the Commission is attempting a backdoor approach via its increasingly strict attitude toward state aids and notification. It has already introduced a policy to require repayment of illegal aid, and the state aid inventory prepared under former competition commissioner Peter Sutherland could herald a further Commission crackdown. (For details see B.5.)

In December 1988 the Commission also introduced a separate policy on aids to the automotive sector. The policy obliges Member States to notify in advance all proposals to grant aid in favour of companies in this sector where the project to be aided exceeds ECU12 million ($13 million) -- i.e., virtually all new projects.

Relations with the EFTA countries

As the EC moves toward its Single Market, the six countries of the European Free Trade Association (Austria, Finland, Iceland, Norway, Sweden and Switzerland) will move as close to membership as possible, and some may seek membership.

Recently however the EC Commission rejected EFTA proposals to participate in the Community's regional development funds, for fear that the EC in return would have to allow EFTA some control over spending and policy decisions. The decision was a clear signal to the EFTA countries that they will not be allowed to slide into a de facto membership situation: each country will have to make the very difficult political decision, and negotiate entry just like all 12 EC members. This is not for the immediate future, however, as the Community has made clear that it will entertain no further membership applications until after 1992.

Whether or not any of the EFTA countries eventually take the plunge is almost irrelevant -- at least from a business point of view. EFTA is already participating either formally or in a de facto manner in a series of EC initiatives aimed at creating a great Europe-wide market -- or "European Economic Space" -- encompassing the 18 EC and EFTA countries. The fact that one of the EC's most influential business groups, the European Industrial Roundtable, is an EC-EFTA hybrid indicates how open the Community is to wider European collaboration.

Collectively, EFTA is the Community's largest trading partner, accounting for 27 per cent of total EC exports to non-member countries and 24 per cent of imports. Switzerland alone ranks second behind the U.S., taking nearly 10 per cent of EC exports. From EFTA's perspective, the trading relationship with the EC is even more dominant, as the Community takes 65 per cent of its exports and supplies 71 per cent of imports. Indeed, trade with the EC is four times that among EFTA members themselves ($191 billion versus $46 billion in 1987).

Although EC-EFTA relations go back to 1959, it was former EC Commissioner Lord Cockfield's 1985 Single Market initiative that prompted intensified contacts. With the successful implementation of the white paper, EFTA countries feared that the elimination of internal borders would place their exports to the EC at a clear disadvantage.

In addition, both trading blocks understand that in today's competitive environment, companies need large home markets to act as springboards for international competition. The enormous EC-EFTA market, encompassing 350 million consumers, is seen as a necessary foundation at least for high tech sectors such as information technology and telecommunications, while markets could remain separate for the traditional industries such as steel and agriculture.

With trade in industrial goods already benefiting from duty-free treatment, further developments in EC-EFTA relations will be aimed primarily at eliminating non-tariff barriers, notably in customs and product standardization.

Indeed, in January 1988 EFTA joined the EC in introducing the EC's Single Administrative Document for trade within and between the two blocks. The SAD replaces up to 60 national documents which had to be processed at customs between the various countries. While the SAD format is very complex, it does open the way for computerization of customs documents.

The EFTA countries along with the EC have participated for years in Europe's standard-setting bodies -- CEPT for telecommunications, CENELEC for electrical security and CEN for all other standards. At the industry level EFTA-based firms participate in SPAG -- the Standards Promotion and Application Group formed by 12 EC-based companies to implement common Euro-standards in information technology. EFTA companies are also participating in the European Telecommunications Standards Institute set up in 1988 to accelerate the drafting of standards in this field.

More recently EFTA is attempting to hook up with EC directive 83/189, which gives Community Member States prior notice of national changes in standards to assure that the changes do not become a non-tariff barrier to trade (see B.4).

The issue of EC-EFTA relations in the run-up to 1992 has just been thrown back into EFTA's court. EC Commission president Jacques Delors has posed two alternatives: the two trading blocs can continue with the same bilateral approach to relations, e.g., EC-Austria, EC-Finland, which would eventually result in a huge free trade area; or EFTA can opt for its own internal consolidation and establish a bloc-to-bloc relationship, covering not only trade but also economics and politics. In the first case, the six EFTA countries must simply accept EC rules, but in the second, Delors holds out the possibility of something different, as yet undefined.

Industry perspectives

Judging from the business impact survey, the EC's external trade policies are of greatest interest to the telecoms, metals/minerals and automotive sectors (Chart B1.1). While the first two view this complex of policies as having a positive impact on their business, some (foreign) auto companies see it as a threat. As to national viewpoints, EC and U.S. firms generally take a positive view, while EFTA companies are more guarded, and the small Japanese sample is sharply divided on this issue.

A comparison of Charts B1.1 and B1.2 affords some insights into industry attitudes. Thus the auto sector, which on balance takes a positive view of EC trade policy, believes it will result in increased barriers to non-EC firms. The same is true of the metals/minerals sector (which includes steel companies), telecommunications and financial services. In most sectors, however, the primary impact of 1992 is expected to be an increase in non-EC competition rather than higher barriers.

These ambivalent attitudes emerge more clearly from some of the interviews conducted for this report:

- A French aerospace executive predicts growing international competition but also greater tensions in the coming years: "In the short and medium term, I expect a negative impact, i.e., higher barriers to trade with non-European countries in aerospace and defence equipment. In the longer term -- say 15 to 20 years from now, when the restructuring of European industry has been completed and the European concept has gained ground -- things will look different."

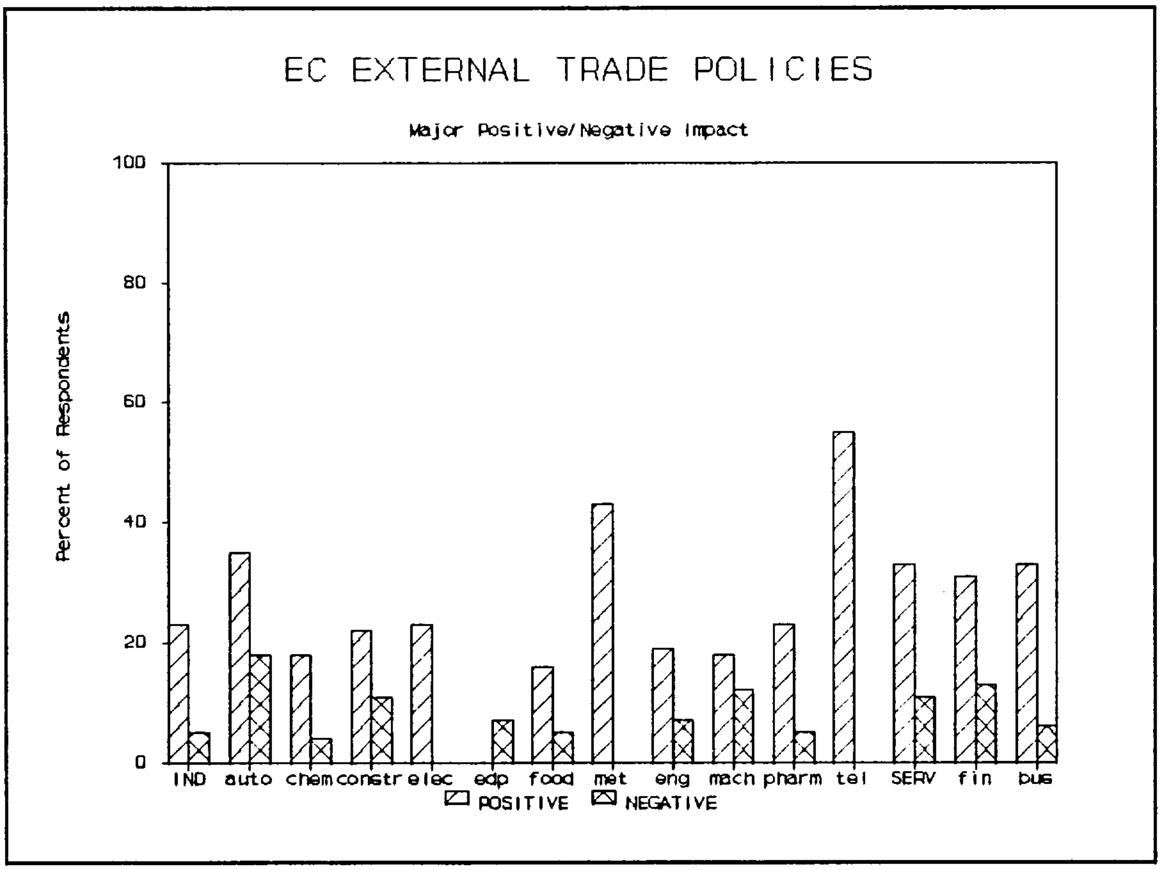
- Another Frenchman disagrees: "EC external trade policy will have a positive impact; it will mean a decline in tariff barriers. I'm not worried about all this Fortress Europe rhetoric. The Europeans will fight on the world market and be in the world market. There may be occasional friction, some reprisals on various products from time to time. But there is no way that the Twelve can agree that any given sector is vital. Each country may try to protect one or several 'vital' sectors, but the Twelve will never agree on what sectors need to be Euro-protected. Unless, that is, the U.S. goes protectionist -- then there will be guerilla wars."

- A German banker discounts Fortress Europe on other grounds: "Because of strong growth in the coming years, especially outside the EC (in Asia and North America), EC firms will expand capacity to meet this demand. After 1992, they will remain world market-oriented. And since they have invested to meet world demand, they will want the markets to remain open in both directions."

- Two Swiss executives are more skeptical. Says one, in the food industry: "Despite EC protestations, I expect they will be more protectionist," partly because of higher unemployment for a few years as companies rationalize and concentrate.

  The second, in mechanical engineering, sees EC protectionism as favourable to his business: "External trade policy will have major effects on the automotive and machine tool industries, two of our major customers. Swiss export/import patterns show that we are almost 100 per cent economically integrated with the EC. The Japanese are our most important competitors. If the EC takes a clear stand against the imports of Japanese cars and can force Japan to play the game of equal trade opportunities, we will have stronger EC clients to sell to. Thus EC external trade policy is strengthening the EC and its allied partners' industry."

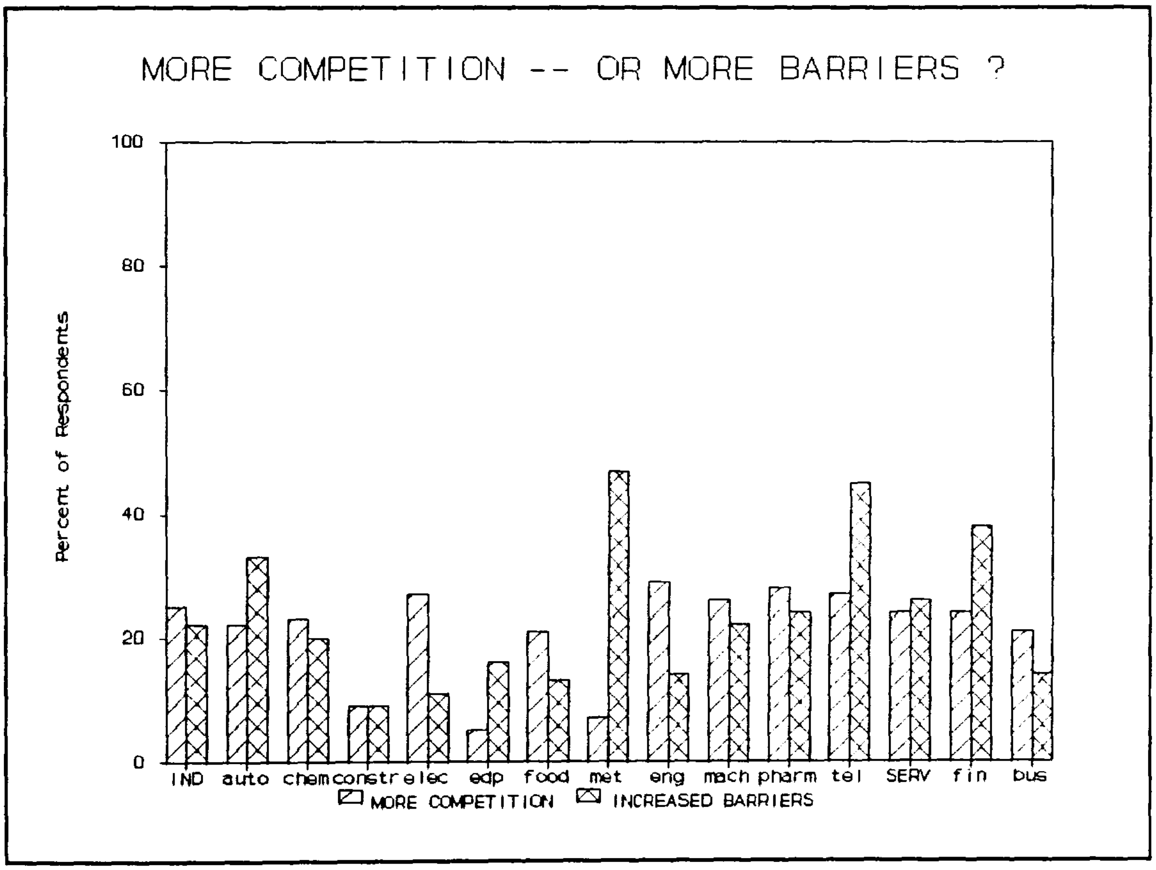
<u>**CHART B1.1**</u>



A U.S. telecoms executive is hopeful that Fortress Europe will not materialize, but is taking precautions to get inside it just in case:

> "I take the leaders of Europe at face value. What they're saying is that to build walls around Europe would be counterproductive to a unit that depends so much on trade and would simply invite retaliation.... I believe that while there are many protectionists around (whether American, Japanese or European), those forces will have a difficult time. The forces of free trade, I think, have the upper hand at the moment. I'm encouraged by the Canadian people having voted recently in what was advertised as a referendum on free trade and having reached the same conclusion.
>
> "I'm in the optimists' camp. I'm also in the camp of free trade from the perspective that it's good for everybody. The danger is that the debate gets into 'this is going to cost 40 jobs in this sector and it's going to do this, and so on,' instead of looking at the big picture.
>
> "I like to tell people that even if you believe there will be Fortress Europe, if you establish yourself within the Community now, that's going to be good for doing business in whatever country you establish yourself in, and if there are barriers erected or maintained in certain industries for certain periods, you're going to be in the best position to cope with that. And the Community's leaders have said the same."

CHART B1.2



B.2 FOREIGN INVESTMENT

Foreign investments will continue to be welcome in Europe, provided the operation makes a clear contribution to the economic wealth of the area and includes either substantial employment or a transfer of technology. EC Member States often compete with each other in efforts to lure MNC investments via generous subsidies and incentives. But all have become increasingly strict and selective in conditioning such aid on employment levels, local content, etc., and this will not change.

Member States however have repeatedly vetoed attempts by the EC Commission to foster a coherent European inward investment policy, in the belief that this would represent a major loss of national sovereignty. As a result, whenever possible the Commission has taken a backdoor route to investment policy. Two examples are its increasing strictness regarding state aids (see B.5) and the introduction of component dumping legislation that requires substantial local content (B.1).

National treatment

Thus far the principle of national treatment applies only to products from other GATT countries, protecting them against discriminatory taxes or other regulations (Article 3 of the GATT). But the agenda of the Uruguay Round includes a start toward the progressive liberalization of trade in services. At the interim review session in Montreal at the end of 1988, it was tentatively agreed that negotiations on a multilateral framework of principles and rules for trade in services "should proceed expeditiously."

Agreement on the framework would be followed by negotiations on sectoral coverage, during which countries could place markers on rules or restrictions they would not immediately be willing to bring into conformity with the blanket rules. The EC, for example, wants the freedom to protect its cultural industries such as broadcasting and films from foreign domination.

Among the tentatively agreed principles is that of national treatment, which in this context means that the services exports or exporters of other GATT members "are accorded ... in respect of all laws, regulations and administrative practices, treatment no less favourable than that accorded domestic services or services providers in the same market."

The multilateral framework will also contain a provision on most-favoured-nation nondiscrimination in services trade. This means that, whenever the Community reaches an agreement on mutual market access with a major trading partner, the benefits (on both sides) would automatically be extended to other GATT signatories.

New entrants setting up in the EC after the adoption of key legislation such as the banking or investment services directives (see B.12) may have to show that their home country affords equitable access for EC companies in order to benefit from the single Community licence. But even this "threat" is viewed by most Member States as a bargaining chip in the Uruguay Round, to force third countries to open their markets in these traditionally regulated service areas.

Rights of establishment

As the EC moves toward becoming a Single Market, the question of what constitutes a European company will become increasingly important in determining who will reap the advantages. The debates regarding local content and reciprocity (see B.1) are manifestations of the same lack of harmonization in this field.

As one expert at UNICE (the European industry federation) points out, the national differences "are just something we will have to live with." Attempts in the 1960s to put in place a convention introducing the mutual recognition of establishment authorizations failed to win Member State approval, and national attitudes do not appear to have changed.

Nevertheless the EC Commission's legal service has carried out a confidential study of what could be done to harmonize establishment rights. Currently the situation varies widely, from the U.K. or the Netherlands where registration or incorporation takes little more than a letter box, to France which has very strict requirements regarding the location of the head office, investments, etc.

Although this confidential study is unlikely to lead to total harmonization, or a legal definition of what constitutes a European company, it will definitely be increasingly important to be as "European" as possible in the post-1992 Single Market. No legal barriers will oppose non-European companies, but there will probably be a de facto preference for Europeans, whether in public procurement, R&D or whatever. Clearly, companies that invest, employ and carry out R&D in the EC will be perceived as more European, and this will work in their favour. Joint ventures are also a way of assuring a European image.

The European Company Statute

In the hope of promoting the creation of trans-European companies, the Commission has started drafting a new text for the European Company Statute. Although both UNICE and the European Industrial Roundtable have questioned the utility of this proposal, the Member States told the Commission in November 1988 to start the redrafting process.

Despite the lack of industry enthusiasm for such a draft, a European Company Statute should be seen not only as a potentially useful instrument for organizing operations in Europe, but also as a basis for EC-wide corporate tax harmonization.

The Commission has described the statute as "essential to the realization of the Single Market," because it will "facilitate and favor industrial cooperation and permit the creation of European corporations capable of competing on equal terms with their Japanese and American rivals."

Currently companies incorporate subsidiaries in each of the 12 Member States according to national rules in force in each country. As a result they must respect 12 different sets of taxation, reporting and labour rules.

Under the Commission's plans, multinationals could opt for incorporation under the European statute -- it would not be obligatory. This would permit them to unify under one legal entity established in one EC country the capital and personnel situated in several Community countries. According to EC experts, there would be one headquarters company that would establish simple service or production units in all other countries. An EC official stressed that, although taxes would continue to be paid in each of the Member States, "there would be some flexibility in setting off profits in one country against losses in another."

For Commission president Jacques Delors, the statute is a key element in the Single Market's "social dimension" (see B.7). Under the scheme companies would have to introduce throughout their operations one of three systems for worker participation: election of worker representatives to the supervisory board; creation of works councils; or company-wide collective bargaining. Member States would be allowed to restrict the choice so that their own companies would not be able to reincorporate under the European Company Statute in order to circumvent national legal requirements.

European Economic Interest Groupings

From July 1, 1989, companies will have the benefit of setting up European Economic Interest Groupings (EEIGs) across the EC. Modeled after the French *groupement d'intérêt économique*, of which the Airbus Consortium is the most famous example, the Community's EEIG would be the first entirely European legal entity. The EEIG regulation was approved in July 1985 to facilitate transborder co-operation between companies.

It provides a common set of rules, independent of national laws, in which to set up such a grouping (which is established by contract rather than incorporated). The regulation itself is directly applicable and requires no national legislation to bring it into force. But Member States must introduce some modifications in their existing company registration procedures to allow legal recognition of such groupings.

The EEIG will be open to all companies provided there are at least two members from two different Member States: the regulation recognizes subsidiaries of one MNC as fulfilling these requirements. Once registered in one Member State, the EEIG can operate throughout the Community without additional registration procedures. Its activities must be ancillary to those of its founding members -- such as joint promotion, distribution or data processing -- and it can employ a maximum of 500 people. Profits or losses will be transferred to its founding companies for taxation purposes.

Regulating takeover bids

The Community is also pushing to harmonize various aspects of company law in the hope of creating a so-called "level playing field" in which firms can compete on equal terms once the Single Market is completed.

A key proposal in this area is the recently proposed directive covering takeover bids. This is viewed as a necessary complement to the 1985 proposal on harmonizing rules regarding mergers. Both are also seen as necessary to assure "equitable protection for shareholders throughout the common market."

The objective of the takeover proposal, according to the Commission, is "to increase the transparency of takeover operations while permitting both the necessary restructuring of European industry and protecting the rights of all shareholders."

The rules would apply to all takeovers within the Community and would require each Member State to set up a national authority responsible for supervising compliance with these rules. Small- and medium-sized companies would be exempt from the procedures.

The main elements in the Commission's proposal concern, firstly, the obligation for a purchaser who has acquired one third of the voting shares in a company to launch a public offer for the rest -- similar to the existing rule in the U.K., where the threshold is 30 per cent. Partial takeovers would become illegal, and in this way EC experts believe "speculation would be avoided."

To minimize the scope for insider dealing, the directive will require a bidder to announce his intention to make a takeover as soon as possible. At a later date -- when the public offer to buy outstanding shares is made -- the bidder must publish a detailed "offer document" outlining its intentions regarding the continuation of the target company's activities, the anticipated level of employment, asset disposals and future debt plans. Once launched, the bid must be completed in four to ten weeks depending on the decision of each Member State.

The proposal rules out only two forms of defensive tactics, but officials stressed that other poison pill defences will be subject to follow-up rules. The two outlawed mechanisms are management's ability to increase the authorized capital (voting shares) of the firm or the "use of exceptional operations which lead to the loss of assets." Such defensive measures could be implemented only if authorized by a general shareholders meeting before the bid was launched.

As to reciprocity, the proposal would leave it open to Member States to block a bid from a non-EC company if EC firms are barred from takeovers in the latter's home country.

Industry perspectives

The political controversy and press scrutiny customarily devoted to trade issues tends to obscure the reality that the primary weapon of international competition these days is not exports but direct investment.

The businesspersons who participated in the survey are well aware of this fact. Asked to rate the impact of 1992 on increased non-EC competition in their sector, whether through investment in the EC or through imports, 31 per cent of the industrialists predicted a strong impact through investment versus only 15 per cent through imports. The imbalance was even greater (30 per cent versus 11 per cent) in the service sectors, which account for the greatest share of output and employment in all advanced economies.

As Chart B2.1 reveals, the expected impact of investment rather than imports is particularly marked in autos, construction, EDP, mechanical engineering and telecoms, as well as in financial and business services.

A good example of non-EC firms' investment strategies is the telecommunications industry, where a new generation of U.S. and Canadian competitors are now seeking to achieve a foothold on European markets. In interviews conducted for this study, executives of two such companies expounded their thinking on how to penetrate EC markets. The first stressed the importance of forging local partnerships:

> "It is not clear yet whether Europe will be open or closed. Probably a bit of both: an open market, with some walls around it. Reciprocity is also still an open issue: it is

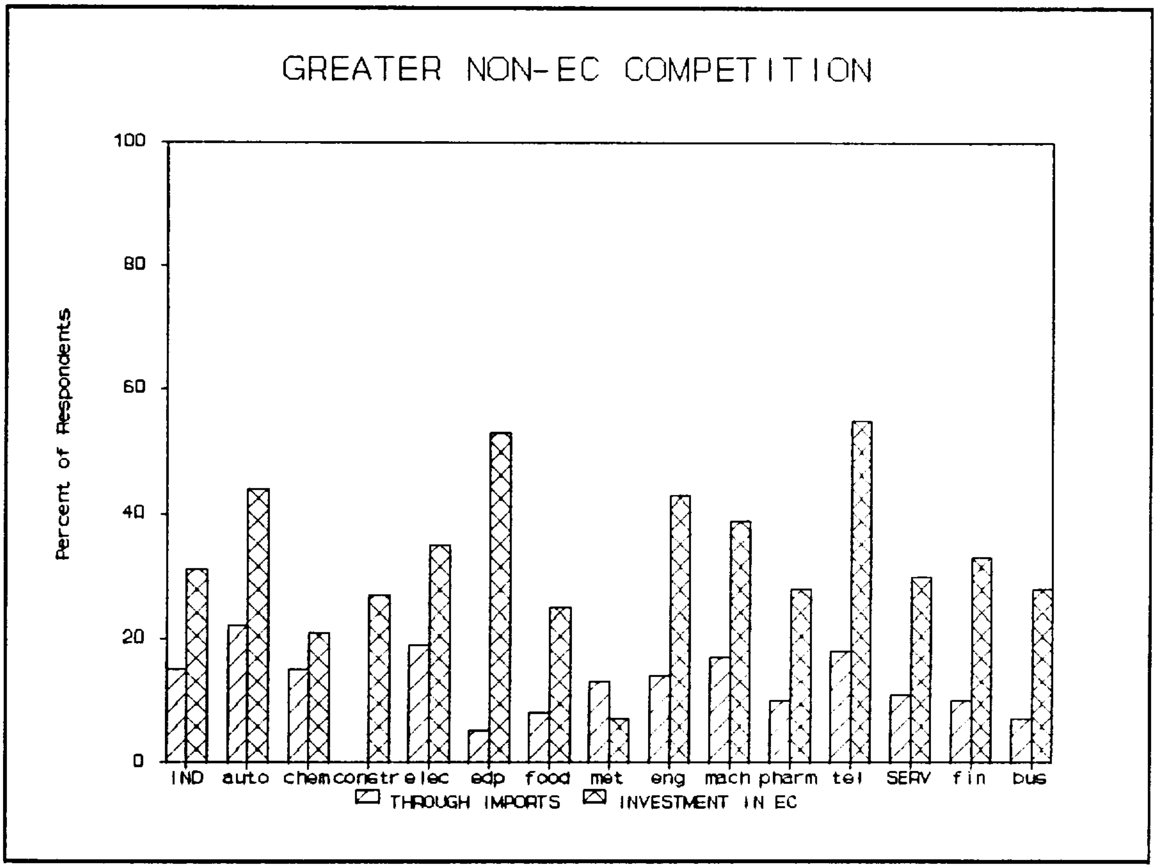
unclear how it will be measured, and how the [U.S.] trade bill will actually be implemented.

"But companies set up in Europe by 1992 and able to provide services and expertise will unquestionably benefit. The name of the game is therefore: can you look European by 1992? In my view, these are the keys to success in looking European: (1) have European partners; (2) have expertise; and (3) have alliances with the national PTTs.

"The real key to success may be the third point -- partnership with the PTTs -- which in turn means (1) having technology and expertise they want, and (2) knowing how to present and manage a complex relationship.

"The PTTs want technology. If you have technology, there is no fortress; the doors are always open. But the really difficult thing is to sell the idea of co-operation. This involves humility and diplomacy. Co-operation has to be presented as a way of optimizing their strategies, of pointing out alternative solutions. They will let you assist them in developing their plan. But one must always remember that it is *their* plan. And that will never change."

CHART B2.1



The second executive, agreeing that the key issue is how to establish a company's European credentials by 1992, focused on the need to "look European" while remaining a global enterprise:

"This means balancing integration benefits with national market requirements -- looking and acting local, but thinking global and globalizing whatever the customer can't see (manufacturing, R&D, distribution networks, even certain less visible aspects of servicing)....

"You must also develop a segmented advertising message: presenting yourself as local where it is important to look local, but publicizing the company's international identity where that is a strong card.

"Of course, all this is very tricky. The challenge is how to manage this segmented marketing image; how to raise your company profile and awareness of your brand name, without endangering existing (public or private) partnerships."

B.3 INTELLECTUAL PROPERTY

Common standards of intellectual property protection (IPP) are viewed by industry as essential for permitting the free flow of ideas, technology and products across Community borders. Unfortunately, IPP is an area where the EC is lagging behind its calendar for action.

The formal adoption in December 1988 of harmonized rules for granting national trademarks was a step in the right direction, however, and two major developments that could come in 1989 -- adoption of the European Trademark Regulation and activation of the long-pending Community Patent Convention (CPC) -- would assist in the drive for a Single Market. The Commission's aim is to have both these agreements in operation by the end of 1992.

The Trademark Regulation would introduce a single trademark valid throughout the 12 Member States, while the CPC would introduce an EC-wide patent. In both cases intellectual property owners would have to carry out only one registration procedure.

Both instruments are currently blocked because currently all Member States except Denmark and Ireland are pressing their claims to house the European Trademark Office. Meanwhile the U.K. is insisting that whatever the final choice, "it must be economically viable," and Bonn argues that German must be one of the official languages wherever the location.

Agreement on the trademark issue will open the way for the Community Patent Convention. For complex constitutional reasons, neither Ireland nor Denmark can implement the Convention, but Spain alone is opposing partial implementation, arguing that its 1986 Accession Treaty with the EC requires total implementation by all 12 Member States or not at all.

International considerations may encourage the reaching of a solution. In June 1989 the EC Commission is scheduled to participate in a major intergovernmental conference aimed at discussing the relationship between the international trademark accord known as the Madrid Agreement and the Community Trademark Regulation. Without adoption of the latter, negotiations might be a little tricky.

This June meeting is of particular importance because it will represent the first time that the Commission negotiates internationally for the Community in the IPP field. The Commission will also attend another intergovernmental conference later this year which will be devoted to protection of semiconductors.

Patents

Currently, inventions can be protected in EC countries either by national patents issued by national patent offices, or by so-called "European Patents" issued by the Munich-based European Patent Office. The latter have the effect of national patents in the contracting states to the European Patent Convention (signed 1973, implemented, 1978); these include some EFTA countries (Austria, Sweden, Switzerland) but exclude some EC members (Denmark, Ireland and Portugal); the applicant must specify those countries in which he wants protection and pay separate fees to each. But the convenience of a centralized application procedure is offset by the fact that litigation on such matters as validity or infringement must be carried out separately in each country under its national law, with results that may be inconsistent.

The EC countries therefore negotiated a separate Community Patent Convention (signed 1975 but not yet in force), the object of which was to create a unitary patent covering all Member States. The CPC would establish a common body of law governing litigation, to be administered by designated courts in each country; their judgments would be valid throughout the Community, with a common appeals court to ensure consistency. During a 10-year transition period, companies will have the option of applying for either Community or single-country patents, but thereafter the idea is that the Community patent will be compulsory for those seeking EC-wide protection.

A Community patent could be licensed for the whole or part of the EC territory, on an exclusive or nonexclusive basis (Article 43). But even if the territorial application is limited to one or more Member States, circulation of the patented product anywhere in the EC would "exhaust" the patentor's right to restrict the use of his patent. Products covered by a Community patent would thus be free to move throughout the EC, provided they are lawfully marketed by the patentor or with his consent. The CPC is thus fully in line with the Commission's ruling practice of thwarting the use of multiple licensing by associated companies for the creation of protected national markets in which the same product can be sold at widely differing prices and conditions.

Trademarks

With regard to trademarks, the Commission is again following a dual-track approach: harmonization of national laws, and creation of a unitary Community Trademark. While the latter is currently blocked, as explained above, progress is starting to show on the harmonization front.

In December 1988 the Council adopted a directive on harmonizing national trademark rules, which will come into force no later than the end of 1992. This directive -- the second adopted in the field of IPP -- is seen as a necessary step toward completing the Single Market, due to its role in assuring the free circulation of products and services. (The first IPP directive dates from December 1986 and introduced special protection for integrated circuits.)

The directive will affect all registered national marks covering both products and services. Trademarks acquired through usage are not covered, but by setting out a clear definition of what can be trademarked, the legislation opens the way for their registration in many cases. (In Germany, for example, shapes like the Perrier or Cointreau bottles cannot be protected via trademarks under existing rules, but the new directive will change this.) The directive provides a uniform definition for the signs or marks that can constitute a trademark as "any sign, mark or shape that can be represented graphically." This same definition appears in the proposed Community Trademark.

The directive also provides an exhaustive list of the acceptable reasons for rejecting or nullifying a trademark, as well as an outline of the rights and obligations of trademark holders. It introduces the obligation on the owner to use the mark or risk losing the rights after five years. It also requires the owner to complain about possible infringements within a five-year period or lose that right.

The directive harmonizes only substantive law issues and does not attempt to deal with procedures. Officials explain that national trademark procedures are so diverse that any attempt to harmonize them would have been impossible at this stage. For example, only six Member States (Denmark, Greece, Ireland, Portugal, Spain and the U.K.) require a search for earlier trademark holders prior to the granting of registration. The other Member States vary between Italy, which has no search requirements, to Germany which operates a mixture of rules and reliance on court control.

The Commission hopes that such procedural inconsistencies will be solved by the Community Trademark Regulation. Officials explain that the owner who wants to register a mark in more than one country will have the option of applying for a Community Trademark via one registration. But (harmonized) national trademarks will continue to exist in parallel with the EC system.

Control of counterfeit goods

Since January 1, 1988, EC customs officials have been empowered to impound and destroy counterfeit goods, i.e. those infringing trademarks, entering the Community at its external borders. The Commission is currently considering the possibility of extending this seizure procedure to products infringing copyrights.

The regulation establishes the following general procedure:

1) The trademark holder with a specific or general problem addresses himself to the competent national authorities in each of the Member States where he holds a trademark. Each administration charges a fee per request and per trademark.

2) If the administration accepts the complaint, it sets a time period during which its customs officials will impound the alleged counterfeit imports. Customs officials will inform both the importer and the trademark owner when they impound products.

3) It is then up to the trademark owner or the national administration to attack the importer in court. If the court upholds the infringement, the products are destroyed without compensation.

Once the Community Trademark is adopted, the Commission will propose to centralize the filing of requests for customs action in Brussels, whence the information will be relayed to all 12 national administrations.

Copyrights

The long-awaited green paper on copyrights published in June 1988 started the Community down the road to harmonization. A series of oral hearings held during the autumn gave the Commission a picture of how the copyright owners, other involved industries, governments and consumers view the problems.

Follow-up legislative proposals will now start to surface, covering a variety of areas including software protection, audio-visual rentals and the question of how to protect copyright owners against infringements made possible via blank recording tapes (audio or visual). Here the prime task will be to draw the line between private copying and commercial piracy.

At the end of 1988 the Commission issued the first of these proposals, on copyright of software programs. This issue includes the crucial question regarding the treatment of interfaces, which permit communication between computers and/or software programs. The draft was accompanied by a Commission declaration on the interrelationship between the abuse of a dominant position and copyright protection for software programs and interfaces: in other words, Article 86 does apply to copyright protection.

The directive calls on Member States to grant copyright protection for software programs as literary expressions. Regarding interfaces, an EC official explains:

> "First of all, copyrights protect the expression of ideas and not the ideas themselves. So where the specifications of an interface constitute simply an idea, it is not eligible for copyright protection. In many instances an interface is nothing more than a rigid formula which allows you to write a compatible software program; in this case the interface is not covered. However, if the interface is more than an idea and embodies creative input, then it may be protected."

It is clear that as a result of this text, some countries will grant copyrights to interfaces and some will not. EC experts recognize that problems will have to be settled in the Court of Justice; nevertheless this proposal remains "a first step toward harmonization."

Biotechnology

Biotechnology development is one area where the Community is striving for specific legislation. EC officials fear that as in all areas of intellectual property protection, Council of Ministers adoption will be slow, since "Member States are still reluctant to recognize Community competence" even though the existing chaos could damage European industrial interests.

They point out that support for the proposals tabled by the Commission, seeking to harmonize the patentability of biotech inventions in the EC, "will divide Member States between those with an industry very much involved in biotech (Germany and the U.K.) and those with no industry at all." The former will urge greater patent protection, while the latter will see no need for it.

The Commission's draft directive seeks to prevent different national rules from acting as barriers to the free flow of patented products. Once adopted by the Council, it would also enhance the legal certainty of obtaining patent protection for these inventions.

Currently the EC's 12 Member States respect two international patent conventions (the 1961 Paris Convention and the 1963 Strasbourg Convention) which were both drawn up at a time "when biotechnological processes were either nonexistent or in their infancy," according to a Commission statement. As a result the application of these conventions to biotechnology inventions varies, with some Member States recognizing the validity of patent protection while others do not.

The motivation behind the harmonization drive is twofold. First, the Commission believes that biotech companies, faced with the current legal uncertainty, are thinking twice about investing in the Community. Indeed, some have opted to invest in the U.S. where patent protection is clearly available. Second, lack of harmonization is putting European firms at a competitive disadvantage with their American and Japanese rivals.

The EC proposal seeks to create protection "comparable but not identical" to that created by U.S. legislation. It would authorize the patentability of a living organism provided that "a sufficient degree of human intervention has occurred." Patent protection would be granted for the traditional 20-year period from the date of filing and, in the case of self-replicating inventions, would cover all generations of the invention during this period.

Under the Commission's proposal, improved plants (such as those with resistance to diseases, pests, drought, salt, pesticides and herbicides) will be patentable, as will new genetic material inserted into plants and animals. The Commission however decided not to propose product patent protection for plants where they have been produced using a known biotechnological process. These so-called "plant varieties" are covered by another system of protection: the Plant Breeders' Rights Convention.

The proposal should also lead to improvements in animal farming, which will benefit from protection for the genetic enhancement of breeding stock, flexibility and precision in breeding methods, and prevention and control of disease.

Council adoption requires only a qualified majority, but the proposal is subject to the two readings of the European Parliament as required by the so-called co-operation procedure. The first reading should take place during 1989, with the Council starting discussions of the text toward yearend.

<u>Patent and know-how licensing</u>

For the Community, assuring the protection of intellectual property is a means to promoting the transfer of technology via licensing agreements. Two recent pieces of competition legislation are particularly important in this area: the 1984 block exemption covering patent licensing and the 1988 exemption for know-how agreements, which often go hand in hand with patent licensing deals.

<u>Patent licences:</u> This regulation came into force at the end of 1984 for a 10-year period. It permits exclusive licences regardless of the size of the companies involved and the degree of technical innovation. Licensors and licensees can be restricted from competing in each others' territories so long as one of the licensed patents remains in force.

Article 2 provides the list of provisions that a licensing agreement may include. These are:

- an obligation to use the licensor's trademark;
- requirements that the licensee procure certain goods or services from the licensor, pay a minimum royalty, produce a minimum quantity of the licensed product, etc.; and
- a five-year restriction on passive sales outside the licensed territory.

According to Article 3, the agreements may *not* include:

- limits on the maximum quantity of products manufactured or sold;
- arrangements not to compete with each other in R&D, manufacturing or sales; or
- extension of the agreements beyond the expiration of the patents originally licensed, etc.

<u>Know-how agreements:</u> This regulation comes into force on April 1, 1989, and will cover both pure know-how agreements (i.e., transfer of non-patentable information such as a description of production procedures, industrial designs or software) and mixed agreements involving a patent or trademark licence and a transfer of know-how essential to manipulating the licence.

To benefit from the block exemption, the know-how involved must be "secret and substantial" and must be identified by the contracting parties at the time of the technology transfer either in writing or in any other appropriate form such as a videocassette or tape. It does not however have to be described in the contract, as proposed in earlier drafts of the regulation.

The regulation permits the granting of an exclusive licence valid within a defined geographic territory. The restrictive clauses agreed upon to protect this exclusive territory against the production, use or sale of the know-how or products manufactured with the help of the know-how by the licensor or another licensee are valid for 10 years from the date that the contract is concluded. The acceptable clauses include a prohibition against the licensee from sublicensing; imposition of quality controls; and continued payment of royalties even after the know-how has entered the public domain.

Despite the territorial protection, parallel imports -- defined as all sales via unauthorized dealers -- must be permitted. However, passive sales to unsolicited buyers can be banned for a five-year period. The Commission decided that this temporary ban "would represent an additional protection needed to encourage technology transfers."

B.4 PRODUCT APPROVAL/MARKET AUTHORIZATIONS

As part of the Single Market program, the Community is trying to move toward mutual recognition of market authorizations among the Member States in all product areas. To this end, product approval or market authorization procedures are becoming much more transparent and subject to very clear and objective criteria. The goal is to assure that other European firms benefit from the same treatment as national firms. Foreign suppliers will benefit as well, protected by the GATT principle of national treatment.

At the same time, wherever possible the EC Commission will introduce requirements for respecting existing European standards, leaving open the possibility of establishing new obligatory standards where they do not yet exist.

Technical harmonization: the new approach

Despite the adoption of over 200 standardization directives during the 1970s and early '80s, intra-EC traders must still hack their way through thickets of technical restrictions. Agricultural produce, processed foodstuffs and manufactured goods are often subject to national controls and specifications introduced to protect consumers or users, to protect the environment (see B.9), or as a means of encouraging local producers. Differences in units and methods of measurement, labeling requirements, health and veterinary standards, etc. have been reduced over the years, but up to now only gradually.

The "new approach" to standards and technical regulations, as set out in the Commission's 1985 white paper and subsequently approved by the Council of Ministers, abandoned attempts to draft detailed, tightly prescriptive harmonization proposals in favour of broad framework directives limited to essential minimum requirements regarding public health and safety, environmental or consumer protection. The use of qualified majority voting has accelerated the decision-making process, and the Council has already adopted or reached common positions on framework directives covering pressure vessels, toys, construction materials, electric appliances (radio interference) and machine safety.

The other key element in the new approach is the principle of mutual recognition, as developed by the Court of Justice in its case law (notably the landmark 1979 ruling on *Cassis de Dijon*). In the Commission's definition, mutual recognition means

> "the acceptance by all Member States of products lawfully and fairly manufactured and sold in any other Member State, even if such products are manufactured on the basis of technical specifications different from those laid down by national laws in force, insofar as the products in question protect in an equivalent fashion the legitimate interests involved."

The Commission will submit proposals in the near future to establish general principles for the mutual recognition of product test results and certificates, thus obviating costly and time-consuming requirements for retesting or recertification in other EC (or EFTA) states.

For non-EC suppliers, mutual recognition implies that a company can make its product conform to the norms of the Member State that suit it best. This would seem to be a great improvement on the present situation whereby authorization must be obtained from each Member State in which it chooses to sell. However, if a Canadian manufacturer chooses to abide by French norms, it would not be able to export directly from Canada to other EC states, but would have to channel its shipments via France. It is for this reason that Member States will push for European norms rather than having to accept potentially 12 different sets of standards.

In its October 1988 position paper on external aspects of 1992, the Commission argues that the Community already applies the GATT code on norms, which gives outside suppliers the same access to national certification procedures as local firms. It adds that the EC could recognize tests and certificates issued by third countries as the equivalent of its own systems, but such mutual recognition would have to be negotiated by Brussels and not by individual Member States.

European standards

Once adopted by the Council, the "new approach" framework directives must then be fleshed out into technical specifications that manufacturers can use. This is left either to national standards bodies -- such as DIN in Germany, AFNOR in France or BSI in the U.K. --

or, where common European standards are necessary, to the Brussels-based regional bodies CEN and CENELEC, whose membership comprises the national organizations of both EC and EFTA countries. (CENELEC deals with electrical goods and CEN with most other products. They work through committees for specific product categories, on which manufacturers are strongly represented.)

Very gradually the Community will move toward the introduction of additional, mandatory European standards -- first in new product and new technology areas, and then perhaps for existing product lines, but only in the distant future.

Information technologies (IT) and telecommunications are receiving priority attention, due to their importance for other sectors and the economy as a whole. Common European standards in these areas are viewed as essential to building dynamic and internationally competitive European IT and telecoms industries. As a result there is a good deal of concern among foreign-based firms regarding the resulting European standards.

As one major MNC points out, "It is the market which chooses the best standard." But the EC Commission as well as European producers -- working through ETSI (the new European Telecommunications Standards Institute) or SPAG (aimed at promoting common standards in the information technologies) -- are trying to develop and impose common standards before a product even reaches the marketplace. This poses two risks: that the market will reject the standard once it hits the market, to the disadvantage of the entire European sector; and that in any case foreign-based firms are being excluded from the initial stages of the standards drafting process, which places them at a disadvantage. Indeed, both SPAG and ETSI are open only to EC and EFTA-based firms and subsidiaries. But as their European members point out, similar organizations in Japan or the U.S. are for natives only as well.

Commission experts admit there is a risk regarding the market acceptability of European norms, but they believe it is a risk the Community is more than willing to take to avoid a repetition of the current situation where manufacturers must at times supply the same product according to 12 national standards. While foreign-based firms concede this is a problem, they fear the Community is about "to create a monster" in order to cure what causes only moderate losses in efficiency in view of today's computer-run factories and flexible production runs.

A related concern for third-country firms is that mandatory EC standards could be used in a discriminatory fashion. The Commission argues that such fears are unfounded because in most instances Community standards will be derived from international ones. But in some instances the differences can be considerable, and as such could be the basis for disputes.

Prospects for key sectors

In the automotive sector, an essential for free circulation is European type approval. This has been on the Commission's agenda since 1970, but will not materialize until agreement has been reached on a common commercial policy for the industry -- i.e., a solution for controlling imports of Japanese cars (see B.1). Until then, Member States will continue to block the remaining three EC directives on technical harmonization in the automobile sector; 41 such technical standards have already been adopted, but the remaining three -- on tires, safety glass, and weights and dimensions -- have been blocked by France (with tacit support from other Member States) for over 10 years. Their approval would open the door to a single Community license for this sector, ending the need for expensive modification procedures in each country.

The current practice is further complicated in that EC standards are optional and coexist with national ones. Whether to ask that the EC norms become mandatory is something on which the Commission has yet to make up its mind (it would not be easily accepted by the Council). Thus, even after European type approval is attained, some of the conflicting national standards could survive, particularly if the Court of Justice can be persuaded that these are justified on safety or environmental grounds. And of course, differences in technical specifications reflecting local customer preference, fiscal rules, etc. would continue to prevail.

Some European automakers (notably the French) fear that their overseas competitors would reap the greatest cost savings from full harmonization, and argue that completion of European type approval should be delayed until EC cars have significantly increased their penetration of the Japanese market.

In the pharmaceutical sector, a 1975 directive (amended 1985) provided for accelerated procedures if a firm wishes to market its product in more than one Member State -- the multistate registration procedure. Under this mechanism, Member States must take into consideration existing authorizations from other Member States. In the end, however, each national authority must decide for itself whether to authorize the product. Pending or forthcoming proposals are designed to extend this system by 1992 to certain excluded categories of medicines.

The Council has also approved (December 1988) the pharmaceuticals pricing transparency directive, which requires national authorities to disclose the criteria used in setting prices when granting first marketing authorizations and admission to social security reimbursement schemes. A follow-up proposal aimed at setting objective and nondiscriminatory criteria for such pricing decisions (which typically favour companies with research or production facilities in the country concerned) is expected in autumn 1989.

Together these directives represent significant progress toward the ultimate goal: a Single Market in medicinal products. The Commission is working on a proposal covering this final stage. But it has not yet decided whether it will follow the mutual recognition approach, which implies reinforcing the multistate registration procedure, or opt for the creation of a European counterpart of the Federal Drug Administration (FDA), which regulates drug authorizations in the U.S. The Commission's proposals should surface during 1989-90.

In telecommunications equipment, the EC took its first step toward mutual recognition of marketing authorizations with a 1986 directive obligating Member States to recognize each others' testing results. The Commission is now working toward legislation introducing full mutual recognition of type approvals, which will be facilitated by implementation of the May 1988 directive requiring abolition of the PTT monopolies over terminal equipment* as well as the extension of open public procurement rules to the telecoms sector (see B.10).

Meanwhile the Commission is proceeding along parallel lines to open up the market for telecoms services, allowing suppliers access to the networks of other Member States. In December 1988, it tabled two closely linked proposals: an Article 90 directive requiring national PTTs to end their service monopolies by 1991 (except for voice telephony and telex); and an "open network" framework directive setting conditions and rules for granting access to value-added network services (VANS) providers. This will be followed up by implementing directives on leased lines, public data networks and integrated services digital networks (ISDN).

It is unlikely that in the near future the Community will look into market authorizations for airplanes, as any move which might benefit U.S. competitors would be met with hostility from those countries involved in manufacturing the European Airbus.

In foodstuffs, the Commission complained in late 1988 that, despite significant progress in adopting framework directives (on additives, labeling, etc.), "the implementing measures they require are subject to cumbersome decision-making procedures, which the Commission deplores." The Commission has long been urging the Council to delegate greater authority to it in this area, but member governments are reluctant to loosen their grip on legislation so sensitive to public health.

Avoiding new barriers

While progress is being made to eliminate existing technical barriers to intra-EC trade, a five-year-old directive is doing its part to head off the creation of new ones.

This "early warning" system requires national authorities to inform the Commission any time they want to introduce new standards or technical regulations. The Commission then relays the information to all other Member States. If the Commission or any other capital believes the directive could represent an obstacle to trade, the Brussels authorities can suggest changes in the proposed standard or call a standstill on its implementation until a European standard is drafted.

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*Issued unilaterally by the Commission under Article 90, this measure is currently being challenged by France (backed by Belgium, Germany and Italy) in the Court of Justice on procedural grounds.

Although the prime objective is to allow all Community industries to benefit from prior knowledge regarding changes in standards, the directive obviously benefits third-country firms established anywhere in the EC. Firms exporting from abroad however will not necessarily benefit from the warning system, although it is certainly in the interests of their importer to keep abreast of the notifications and changes.

The EFTA countries are working closely with the Commission to try to create a linkup with this directive so that their industries can benefit. The main obstacle to EFTA participation is that for the moment no similar prior notification system exists among the six EFTA countries.

In a report issued in December 1988 summarizing the impact of this directive on national practices, the Commission recognized that "There is still a long way to go before the directive can be said to have fulfilled expectations, although significant progress has been made toward achieving greater transparency."

To remedy the situation, the Commission is going to hire consultants in each Member State to survey all published sources of technical regulations with a view to detecting unnotified measures. It also plans a much stricter attitude toward commencing infringement procedures against Member States for noncompliance.

As of January 1, 1989, the directive is being extended to cover several important areas -- agricultural products, foodstuffs, pharmaceuticals and cosmetics -- that were originally excluded when the directive was introduced in 1983.

<u>Industry perspectives</u>

When asked which aspects of the Single Market program could have a strong impact on their business, more industrialists in the business impact survey cited removal of technical barriers (57 per cent) and creation of EC standards (51 per cent) than any other factor. But only a third of them expect much progress on this front by 1992; most put the probable timing at 1995 to 2000.

As shown in Chart B4.1, removal of technical barriers is seen as a strong positive factor by around 80 per cent of companies in the telecommunications, machinery and EDP sectors. In the auto and construction/building materials industries, by contrast, only about 50 per cent are strongly in favour, while a sizeable minority (11 per cent and 18 per cent respectively) see this as a major *negative* impact on their business. In the auto sector, EC-based firms depend on the few remaining unharmonized technical requirements (on tires, safety glass, and weights and dimensions) to control imports of Japanese cars; with the removal of Article 115 and border customs checks, countries such as France could still use national standards to prevent Japanese cars from entering via a neighbouring Member State. And innumerable national standards covering buildings and the materials used in their construction (backed by insurers who specify that these standards must be complied with) serve to protect local suppliers from import competition.

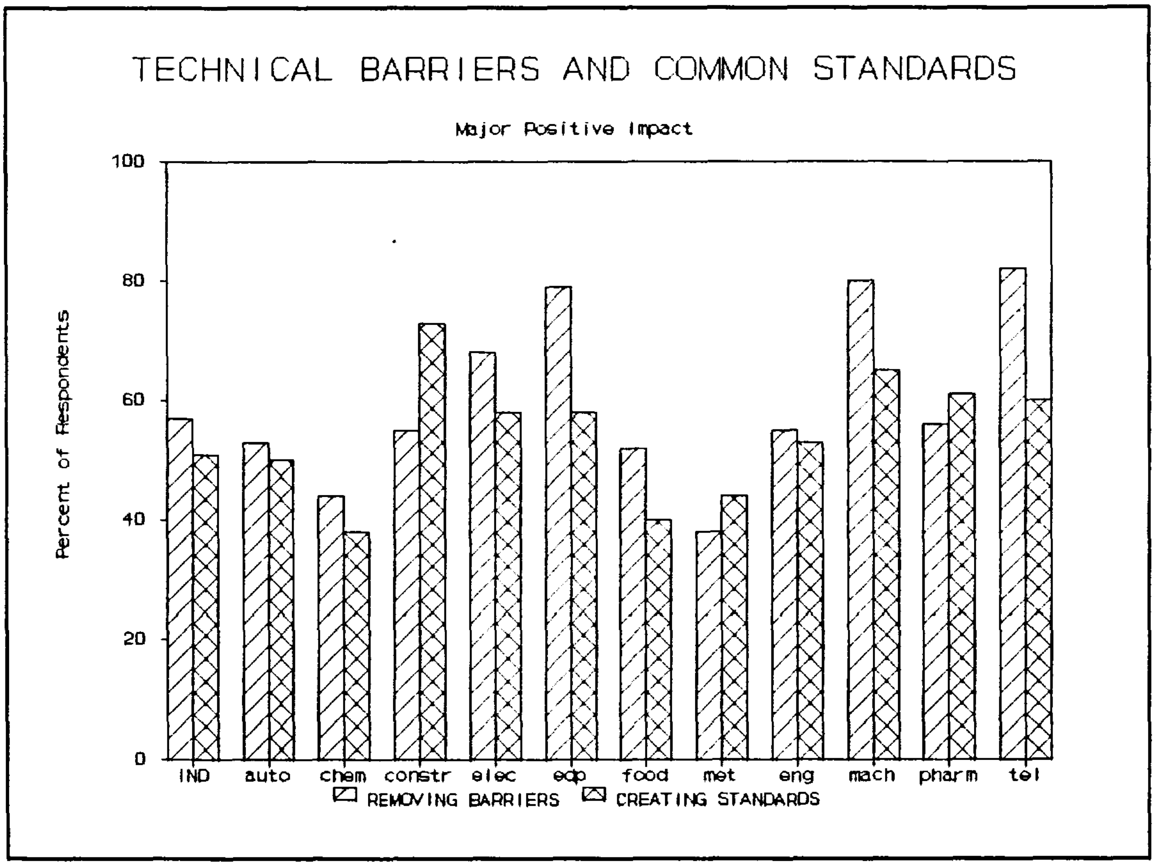
For the same reason, creation of EC standards is viewed most positively by construction/building materials firms (73 per cent), followed by machinery, pharmaceuticals and telecoms companies. Again, there are minorities of about 10 per cent in autos and construction who see this as a major threat.

Interviews with executives illuminate the attitudes in various industries toward this complex of issues.

In *construction materials*, a U.S. manufacturer foresees slow progress:

> "The standards for water pressures, for water control differ. They fall into two categories: there's the U.K. and there's the Continent. Now if the technical barriers fall, then people can move from one to the other more readily. Mind you, I think there will be a lot of resistance -- which would be historical, because people like plumbers are traditionally very conservative. So it'll take a very long time -- we're talking maybe the turn of the century -- particularly in the U.K., before they accept the Continental standards. It's the Continental ones that will win, because the U.K. ones are too expensive."

CHART B4.1



A major French producer in the same industry sees harmonization as more important to smaller firms:

> "As we are already a multinational based in several European countries, we can keep in touch with what is happening on the standards front. For example, the fear often expressed by the French that European norms will be principally German norms because Germany always has so many, for us is less evident because we are ourselves in Germany.
>
> "So for us, norms are something that need watching, yes, but not a major concern. This will be a worry for smaller companies located in Limoges or Poitiers who want to export to Germany. As for us, we don't export to Germany, we are already established there."

In the *chemical* industry, the German giant Bayer makes a similar point:

> "Smaller competitors could become more of a threat as the costly national approval processes, which now often confine them to their domestic markets, will be loosened, giving them access to new markets. Smaller firms will then be able to take advantage of the economies of scale. The less flexible will suffer."

An Italian chemical industry consultant describes the special problem of pesticide norms:

> "In the pesticides business you can't begin to talk about real free trade until you get rid of the current technical barriers. Arriving at this stage will require a titanic effort, not only because of each country's own requirements and standards behind things like product registration and residual levels, but also because of continuing changes brought on by technological advances and new products entering the market.

"The absolute number one problem facing the pesticides industry vis-à-vis 1992 is 'homologation,' or product registration. Currently companies have to deal with each country's bureaucrats, who are not exactly ready to give up control or much less agree to the idea of accepting registration in the country of origin within their own domain. Until there is some sort of unified European body in charge of approvals for pesticides, there will be no unified market for the industry....

"I think the EC will have to come up with something which allows Member States a certain degree of flexibility and independence to judge what is acceptable in their own countries, on things like safety and environmental impact. There will have to be all sorts of loopholes.

"Take the question of pesticide residuals in food; these vary enormously from country to country. Italy for example tolerates very low residuals for pasta because so much of it is consumed, whereas the level is higher in Germany where local consumption is considerably lower. The same applies to all sorts of different food products and crops, depending on eating habits."

In the *food* industry, a medium-sized Swiss company finds it must produce within the Community to get around EC technical barriers:

"We are looking to benefit from the EC-wide standards being developed for processed foods. At present, Spanish jams or Dutch soft drinks can be sold in the U.K. without problems [under the *Cassis de Dijon* principle], but non-EC goods must meet each Member State's separate standards, and this causes us problems. For example, the Germans now have to accept French beer, but not Swiss beer. And Swiss beer has to meet German requirements in Germany and French requirements in France. So we are manufacturing in our EC subsidiaries to meet EC sales."

Food retailers also expect to benefit, but are not expecting an early breakthrough:

- A Swiss supermarket chain: "As a purchaser and retailer, we may be able to profit from greater competition that will result from an integrated EC market. However, there are lots of harmonization problems which will not be solved until the end of the 1990s. Switzerland will follow these developments and will make bilateral arrangements where necessary."

- A French hypermarket group: "Europe has already decided on mutual recognition of standards in the food industry. But the French government is waging a rear-guard battle, which will only hurt French food producers. I don't believe there will be a general lowering of standards; quality of some products will decline, but there will be a market for lower quality/lower price goods, just as there will always be a market for higher quality/higher price goods. Distributors will stock the whole range of products, simply because it is in their interest to do so."

In the *EDP* industry, a U.S. computer maker stresses that "common standards also have a close relation with public procurement. EC policy is not to say that you have to comply with EC standards. But if you don't, you can't bid."

In *machinery*, a British manufacturer of capital equipment for the steel and auto industries reports similar problems, which will not disappear by 1992:

"Any machinery we supply to France must be equipped with a French-made control system and microprocessors. The same for Italy, Germany, etc. -- every customer specifies his own local supplier of these components. I can tell you, chauvinism is alive and well in the EC countries."

In the tightly regulated *pharmaceutical* industry, three companies expressed somewhat different views on the question of product approval:

- A U.S. drug maker's subsidiary in France: "There are two stages in French drug approval. The first is technical authorization to market; your product gets a classification based on novelty, efficacy and so forth. The second is the economic evaluation, in which a company must negotiate with the ministry on a price. This is influenced by commitments to manufacture in France, to export, to do local R&D, etc.

The initial price is crucial, because later price increases are grudging and do not reflect inflation....

"It's not clear yet whether the EC will opt for centralized approval by a new EC agency -- a sort of "super-FDA" -- or for some mutual recognition system. Most people in the industry favour the latter. The main benefit for companies from streamlined authorization would be savings in cost -- not time, which would not be greatly reduced. Companies would still have to go through the approval process in each market, but could present the clinical trials data used in the first country with only a few extras."

- Another U.S. pharmaceutical firm: "Personally I see implementation more around 1995 for the registration of new products, which is fundamental to us. You have on the one hand the fact that each country has its own legislation. Secondly, there is an economic aspect, because with the health schemes which exist in each of the countries, the governments are practically our major customers, so when a government gives authorization to market a product it immediately knows this will increase its expenses. The third thing we have to deal with is the health issue, which is very sensitive.

  "The amount of time is certainly the most critical point. The time it takes for approval of new products, generally speaking, ranges I would say from 18 months to three to four years."

- A major Italian drug company: "Essentially we believe a strong unified European market will be a good thing in general, and we hope to benefit from some of the changes and simplification of procedures, on drug registration, etc. that the new market will bring. We see these as things that may make life easier, but we are not waiting around for things to happen to move. We are already strong in Europe and have learned to work with the rules that exist in each country market; if things become easier, that will be nice but not overly significant....

  "We are rather doubtful that things will be as simple as promised, with registration at the country of origin good for everyone else. The thinking here is that a 'European' standard will be developed acceptable to all."

In the *telecoms* industry, the consensus of executives interviewed is that liberalization in this field will take time and the post-1992 market will not be completely unified.

- A U.S. telecoms equipment supplier: "As an example of the current delays, it took several years before we gained the type acceptance for our digital PABX in the U.K. The process took so much time that part way through we decided that the system being tested was not the one we wanted to offer, so then we had to start all over again....

  "Just the fact of making common standards for different telecoms products will have the effect of making more markets reachable. But in telecoms there is certainly not going to be any European PTT established. There will continue to be individual country units with their own objectives, their own priorities as to what kind of services and products they want to see offered to consumers in their countries. For example, there will continue to be countries in Europe that do not have sizeable videotex markets à la France."

- A Canadian supplier: "We are getting ready for *total* deregulation, and see ourselves as ready to compete in a truly unified market. But I believe that deregulation will be only partial, not total: 1992 will be a halfway house. Preparing for 1992 and the partial deregulation it portends requires certain changes, and will have a cost. But they are piddling compared to the gains to be reaped in a Single Market of 320 million consumers."

- A Spanish telecoms manufacturer: "I agree we will not have real liberalization of the telecoms market by 1992 -- EC countries will maintain protectionist barriers somehow. After all, the telecoms sector represents 7 per cent of GDP. So a global market will take longer than 10 to 15 years. It's important to protect oneself in telecoms -- I don't feel liberal at all. But there are different levels of protection, some justified (like antidumping), others not."

A number of companies interviewed for this study -- both EC and non-EC firms -- stressed the importance of participating in national and pan-European industry groups working on standards in their industry. EFTA and U.S. companies can participate through their EC subsidiaries. For example, a U.S. lamp manufacturer reported that the European Lighting Council will be headed for the next three years by one of its executives. "So far the lighting standards are still in draft form. But since we are so active in the trade association, we foresee no difficulty in getting our views adopted by the other members."

B.5 COMPETITION POLICY AND STATE AIDS

Former competition commissioner Peter Sutherland believed that the Internal Market White Paper "made it clear that competition policy is essential to the Single Market." Although he stressed that the basic goals and justification for competition policy will remain the same, the Single Market will require "a dynamic view of competition policy to maintain the momentum." The Commission's fear is that, as the barriers come down, companies might resort to anticompetitive practices to offset the effects of removing the protection.

The Commission believes that unification in 1992 will require the introduction of a European merger control regulation and a tightening of state aid policies. At the end of 1988 it issued two new block exemptions, covering franchise agreements and know-how licensing accords, which fill in important gaps in competition policy. Following the adoption of the merger regulation, the Commission plans to issue guidelines on joint ventures.

Competition rules are the one area of Community legislation where the Commission can act without approval from the Council of Ministers (although the Commission does carry out in-depth informal consultations with Member States and industry regarding many aspects of its powers). The one exception is the merger control regulation, which must be approved unanimously by the Council.

Merger control

Adoption of the merger control regulation is inevitable and should take place before the end of 1989. Originally launched in 1973, the proposal has gone through various drafts and will undoubtedly be amended further before passage.

The regulation, whatever its final form, will grant the Commission prior vetting rights over any merger with a "European dimension" (see below). In November 1988 all Member States agreed that once a merger did fall into the Community net, the Commission would have exclusive authority to approve, modify or reject the operation.

The fact that it took Member States 15 years to agree on what would appear as a simple necessity indicates the importance of this regulation, which goes to the heart of national sovereignty. Whether for competition or industrial policy reasons, all member governments have intervened to prevent or try to prevent at least one major trans-European merger in the past. But over the last couple years there does seem to be a change of attitude, as governments have become aware that in order to realize the economies of scale necessary to compete internationally, European companies need to be bigger in some areas. And the wave of acquisitions touched off by the approach of 1992 has given the issue fresh urgency.

This urgency is reinforced by Sutherland's very clear demonstration that, although the Commission cannot yet intervene prior to a merger, it can take advantage of existing regulations to intervene following a merger. Via Article 85 (which bans anticompetitive agreements between companies but provides for exemptions) coupled with Article 86 (banning the abuse of a dominant position), the Commission is sufficiently armed to provoke a good deal of legal uncertainty in the market. The Court of Justice upheld this approach in its landmark 1987 judgment on the agreement between Philip Morris and South Africa's Rembrandt Group regarding the U.S. company's investment in Rothmans International of the U.K.

Even before the Commission scored this important victory, firms embarking on a major cross-border merger or takeover would routinely take the precaution of informally consulting the Commission prior to carrying out the operation. Since Philip Morris, Brussels has become an even more important stop, both for acquirors and for companies mounting a defence against an unwelcome takeover bid. In the special case of consortium bids, the Commission has even been able to wield Article 85 to intervene in advance: thus it blocked the collusive takeover of Irish Distillers by three major U.K. drinks firms, while the GEC/Siemens joint bid for Plessey is currently under formal investigation.

This aggressive exercise of the Commission's de facto authority has further helped to bring Member States around to the need for regulation.

There remains wide disagreement among Member States and the Commission regarding three key elements in the current draft: the thresholds for defining a merger of "European dimension," the proposed automatic suspension of pending mergers, and whether industrial policy objectives can play a role in the approval process or whether antitrust considerations alone should play. The disagreements are significant, and it is likely that when the final text is adopted at some point before the end of 1989 it will differ significantly from the current version. It will be left to the new competition commissioner, Leon Brittan, to propose the necessary changes.

The current Commission draft ascribes a European dimension to any merger resulting in a combined world-wide turnover of ECU1 billion. Other criteria would exclude mergers in which over 75 per cent of joint turnover was in one Member State, or where the target firm's turnover is under ECU50 million. In discussions with the Council, the Commission has subsequently retreated on the threshold turnover levels to ECU2 billion and ECU100 million respectively.

According to EC officials, the ECU1 billion threshold already excludes roughly 8 per cent of the European economy, while the ECU2 billion level would exclude 15 per cent of the economy as well as certain specific industries (such as clocks and watches, heating appliances and carpets). But the ECU10 billion threshold most recently floated by the U.K. and Germany would drastically narrow the scope of Brussels' new powers. To its proponents, this is just the point, as they fear the Commission would be unable to cope with the heavy case load that a lower threshold would require. According to Germany's Federal Cartel Office (FCO), an ECU2 billion threshold would mean Brussels would have to study at least 100 deals a year, compared with only 10 to 20 in excess of ECU10 billion.

The draft regulation also calls for an automatic one-month suspension of all mergers that fall into the EC's net until the Commission can complete a preliminary investigation. If this investigation determines that certain aspects are contrary to competition rules, then a further four-month suspension would apply. The U.K., France, Italy and Spain argue that the suspension should be much more selective, being invoked only when the Commission has reason to believe that the merger is anticompetitive. Although Germany supports the Commission's proposal (as a German spokesman pointed out, "it is very hard to unscramble eggs" once they have been merged), the Commission is prepared to give in on this point.

The third problem, concerning industrial policy considerations, is of course a highly political one. Some governments, led by France, would like to see industrial policy play a role, encouraging corporate linkups to create European champions against the U.S. and Japanese. But Germany and the U.K. are adamant that only antitrust considerations should figure in Brussels' decision-making, primarily because they want to limit as much as possible the Commission's discretionary powers. Both countries have mechanisms for exerting ultimate political control over decisions of their own competition authorities -- in Germany through the federal Economics Minister's power to overrule the FCO (as may occur with Daimler/MBB), and in the U.K. through the system of ministerial decisions based on ill-defined "public interest" grounds.

Thus the U.K. has always argued that the criteria by which the EC Commission approves or rejects a merger should be limited to competition considerations. However, U.K. officials stress that in a number of areas Member States should retain the power to block a European merger, including possibly even overruling the Commission. These areas are essentially national security considerations, and mergers linked to the civil aviation sector due to the national identity of airlines.

Once the new merger regulation is safely under the Commission's arm, experts will turn to drafting guidelines for joint ventures. Drafts were circulated several years ago, but the Commission decided that since joint ventures are so linked to mergers, it would wait to see the final text of the merger regulation before proceeding in the joint venture area. The Commission takes a generally positive view of JVs as a means of spreading technology and improving industrial efficiency. Thus in 1987-88 it granted approval to several JVs that encouraged rationalization (in petrochemicals) or transfers of important new technologies (Olivetti/Canon in fax and photocopiers).

Block exemptions

Block exemptions provide derogations from the basic Rome Treaty prohibition for certain categories of intercompany agreements. Article 85 bans all anticompetitive agreements, but then gives the Commission authority to exempt those that "contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefits."

The block exemptions provide a list of dos and don'ts for companies framing agreements and provide a guarantee that any agreements respecting the detailed provisions will not be judged illegal at a later date. The Commission does of course reserve the right to censor companies if the agreements are not implemented according to the rules. An agreement that does not comply with the provisions must be notified to the Commission for approval. Such notifications now benefit from the so-called "opposition or accelerated procedure," which means that if the authorities have not replied within six months, companies can consider the agreement to be compatible with EC competition rules.

Currently block exemptions cover exclusive distribution, selective distribution in the auto sector, R&D agreements, specialization and patent licensing. Exemptions for know-how licensing and franchise agreements were approved in December 1988 and will go into effect during 1989.

The recently adopted know-how exemption (discussed in B.3) is of vast importance for industry, as roughly two thirds of all technology transfer contracts in the Community involve some sort of know-how agreement.

Franchising agreements are important for specific sectors. They have multiplied in the EC in recent years in part because for the foreign-based enterprise "they provide a perfect instrument for penetrating the EC market by basing its operations on local talents," according to EC experts. Franchising is also popular among small firms "because the networks permit them to compete with large distribution centres with minimal investment." Well-known examples of franchisors operating in the EC include MacDonalds fast foods, Computerland, and Yves Rocher beauty products.

Both service and distribution franchises are covered in the new block exemption, which comes into force February 1, 1989. The regulation allows the assignment of exclusive geographic territories for the franchisees, provided parallel imports and passive sales are permitted.

To protect the exclusivity the franchisee may be prohibited from selling any other products or providing a service other than that supplied by the franchisor, but the franchisor cannot enforce set prices (retail price maintenance) throughout the network. At the end of the contract the franchisee may also be restricted from setting up competing businesses for a one-year period, but may not be restricted from taking a minority share in such a business.

Dawn raids

An area where the Commission's activities may be curtailed rather than extended concerns its investigatory powers.

In January 1987 Germany's Hoechst AG complained to the Court of Justice contending that, although European law may take precedence over national law, the former must respect the latter. In April two subsidiaries of Dow Chemical in Europe joined the complaint. The Court's final judgment could take a couple of years.

The case stemmed from Hoechst's refusal to admit EC investigators to its Frankfurt offices. The EC was seeking information regarding an alleged price-fixing cartel among polyethylene and PVC producers. Hoechst contended that under German law any general investigation required a warrant signed by a judge; without this signature the search warrant must specify what information is being sought. Since the Commission's warrant was general, Hoechst refused to accept it.

Although Hoechst finally allowed access to EC investigators, the firm has continued with its complaint at the Court. A Hoechst executive explained that "Even if European law does have primacy over national law, it has to respect it. This is one of the problems of having imposed a European competition law on top of national systems and not replacing one with the other."

Unlike Hoechst, the Dow Chemical companies had allowed access to the EC investigators; but a spokesman explains that "We believe the Community must define limits to the Commission's rights, and without a court case we cannot do this." They are seeking a nullification of the Commission's investigatory warrant due to its vagueness. In their arguments they point out that the warrant does not specify an exact time period, relevant market or specific product of the alleged infraction, and thanks to its vagueness, EC investigators took documents with them that were unrelated to either the polyethylene or PVC markets.

Both Dow and Hoechst were among 23 producers fined a total of ECU60 million in December 1988 for their participation in the cartel.

State aids

The scheduled completion of the Community's Single Market, says the Commission, requires a "strict containment" of state aids that could otherwise distort competition and thereby counteract the positive effects of eliminating the remaining barriers to intra-EC trade. The Commission will however have to fight an uphill battle even to achieve a standoff with national governments for whom state aids are a vital instrument of industrial as well as regional policy.

Although EC officials doubt that they will introduce any new legal instruments before 1992, they do expect to reinforce compliance with existing EC rules. These include prior notification requirements, definitions of regions eligible for higher aids, guidelines regarding R&D subsidies and the accumulation of aids, and -- perhaps most important -- the 1983 decision to force companies to reimburse illegal state aids.

The extent of the state aid problem is best illustrated by a statistic: Member States already spend 3 per cent of GDP on state aids, or roughly ECU2 000 per worker in manufacturing. Moreover, the Commission reckons that the completion of the Single Market could, at least in the short term, add up to 500 000 to the unemployment list, so that Member States may try to further increase their spending.

The scenario is further complicated by the likelihood that, if Brussels continues to treat aid granted in the peripheral countries the same way it restricts aid in the central EC market, Dublin, Athens, Lisbon and Edinburgh may revolt. Theoretically these areas are allowed higher levels of regional aid, but the perception in these capitals is that the differences are not enough. For outlying areas, they contend, the extra aid merely compensates for the extra transport costs and in no way represents an unfair advantage.

These peripheral countries in fact feel particularly squeezed and concerned by the EFTA push for the creation of one "European Economic Space" which would permit the Scandinavians to benefit from the EC's Single Market without being subject to any of its restrictions, including those on national aid.

Faced with these problems, the Commission has carried out a thorough survey of all subsidies available in each Member State, as well as an in-depth study of state aid notification policies. Both studies will serve as a backup for Commission measures aimed at tightening up national practices.

The Inventory of State Aids

The Commission completed its so-called "Inventory of State Aids" in the summer of 1988, but did not make it public for six months. On first reading, said then competition commissioner Peter Sutherland, "It made my hair stand on end."

The 90-page inventory including annexes was finally released in December. It estimates that total aid is running at ECU100 bn per year, with most going into crisis sectors. In Sutherland's view, this explains why Europe has such a high unemployment rate: what, he asked, would the effect have been if the funds had been spent instead on growth sectors? The inventory portrays a very disparate situation, with U.K. subsidies amounting to only 50 per cent of the French level while German aid runs 40 per cent above. Italian subsidies represent four times the French amount.

In presenting the study, Sutherland stressed that it clearly demonstrates the need for transparency in aid policy and for the Commission's efforts to control state aids: "In the run-up to 1992, this issue will be of extreme importance." EC officials admit that they "will never succeed in eliminating the state aid problem"; they just "hope to contain it."

With this in mind, the Commission plans to continue its policy of forcing reimbursement of illegal aids. In addition, rather than simply approve state aids, the Commission will increasingly attach conditions, which it will closely monitor via reporting requirements. Finally, Brussels has begun the process of reviewing all state aid programs authorized over the last 20 years. As an expert explained, "Governments never end programs, they just keep piling them up -- and today some of them no longer correspond to economic realities."

<u>Reclaiming illegal aids</u>

National experts believe that the forced reimbursement of illegal state aids will probably be the most effective instrument at the Commission's disposal, because while Member States may try to ignore EC guidelines, no company is going to take the risk of accepting aid that will have to be paid back in two to three years time.

On the other hand, companies have started complaining to the Court of Justice against Commission decisions requiring repayment of the illegal aids. Case Poclain, a subsidiary of the U.S.' Tenneco, has appealed to the Court for annulment of the Commission's March 1988 decision condemning Ffr137 million in aid granted to the company in 1985 by the French state. The company contests various aspects of the Commission's decision, but also contends that it violates the principle of legitimate expectation which holds that after a certain time a company is entitled to consider that the funds it has received were paid according to the correct procedures.

The Commission has in fact started the process of tightening up procedures by setting clearer deadlines on how long the Member States have to respond to Commission queries and how long the Commission has to act.

<u>Notification procedures</u>

The Commission's effort to force Member States into stricter compliance with state aid notification rules will also play a role in containing the subsidy problem.

Based on their review of notification practices, the EC authorities opened complaint procedures against France, Italy, Greece, Spain and Belgium for their failure to respect Community rules requiring the prior notification of state aids as called for in Article 93(3) of the Rome Treaty. While all governments were guilty at times of either failing to notify the Commission or notifying after the aid had been granted, only these five were consistent violators of the rules.

The Commission's complaint is based on Article 169 of the Rome Treaty, which enables the Commission to take Member States to court for failing to fulfill their Treaty obligations.

An EC official claims that the opening of infringement proceedings is "purely procedural," but is nevertheless "a useful warning to those Member States who are particularly forgetful regarding the politically sensitive aid grants." It is precisely these grants, which represent "about 10 per cent of all aid granted," that cause the problems, according to the official.

Over the period 1985-87 the Commission identified a total of 149 cases of non-notification. France was found to be the worst offender, both in number of violations and the value of unnotified aid as a percentage of total aids (notified or not) granted by each state:

	number	*value*
France	47	37%
Italy	33	16
Germany	17	7
Belgium	14	31
Greece	7	28
Portugal	7	8
Spain	6	23
Netherlands	6	12
U.K.	5	6
Ireland	4	22
Denmark	2	3
Luxembourg	1	11
Total	*149*	*18%*

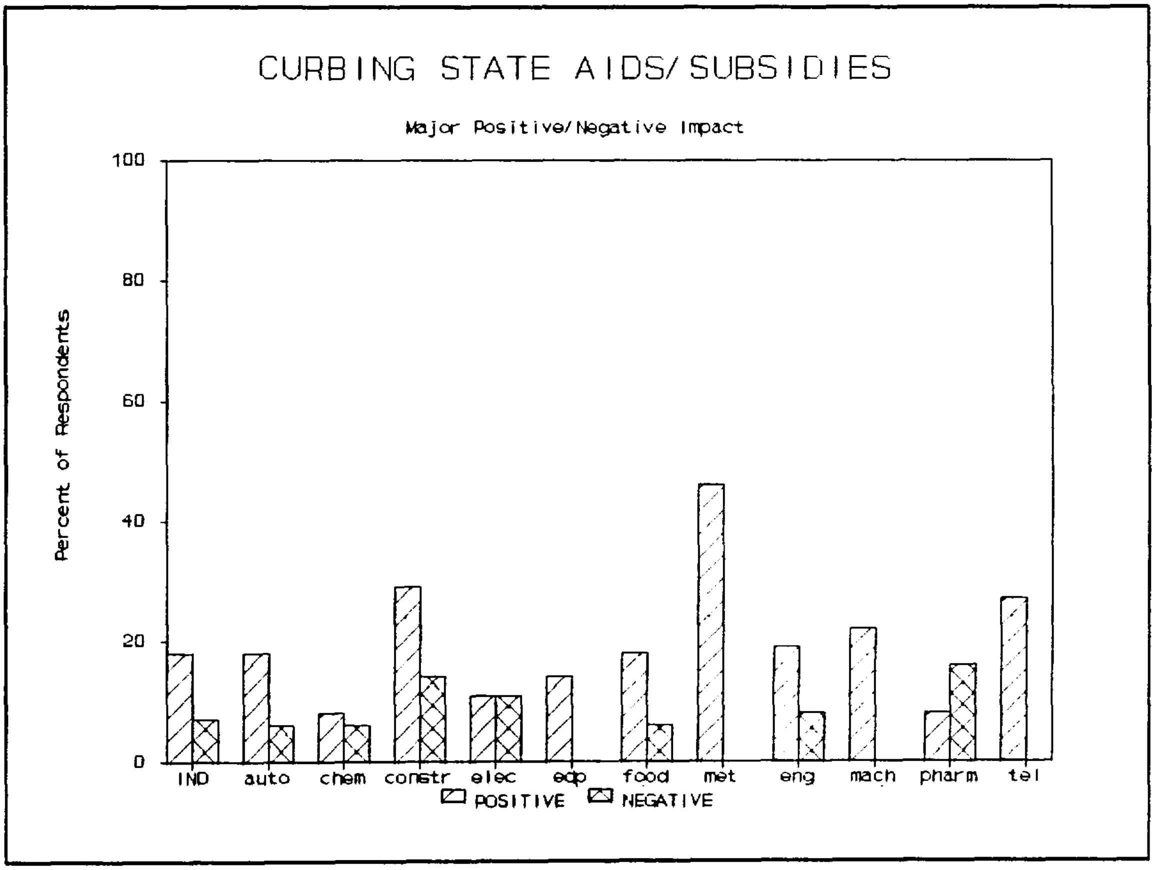
Officials stress that the majority of these infractions concern late notifications, in most cases related to aid granted by regional or local authorities: "By the time the notification has gone from these authorities to the central administration which then passes it along to us, the aid has usually been granted." Since notification should, according to the rules, take place at the project stage, this type of infraction has multiplied.

In the hope of correcting this situation, the five governments must reply within two months to a series of questions posed by the Commission concerning what new internal mechanisms they plan to introduce to ensure that the notification requirements are respected.

Industry perspectives

Most respondents to the business impact survey see the curbing of state aids and subsidies as only a minor benefit of the 1992 program (54 per cent), or a minor disadvantage (19 per cent). The only sectors where this was cited more often as a major positive or negative factor are metals/minerals (which includes the steel industry, still struggling to eliminate anticompetitive state aids), construction, pharmaceuticals and telecoms (Chart B5.1).

CHART B5.1



B.6 REGIONAL DEVELOPMENT

The structural funds

The integration of the EC economy through the Single Market program poses dangers as well as opportunities for outlying and disadvantaged regions. Elimination of the remaining barriers to intra-EC trade, they fear, will serve only to reduce the need for companies to invest in the peripheral areas. As a result, investments will become even more concentrated in the central Community and differences in economic wealth will widen.

To counteract this threat, greater emphasis is being given to policies designed to boost development of the less prosperous regions. In February 1988 the heads of state agreed in principle to double the volume of the Community's "structural funds" -- to ECU14.4 billion by 1993 (at 1988 prices), or roughly 25 per cent of the Community budget. And in June they laid down four main objectives for the funds:

- development and structural adjustment of poorer regions, i.e., Portugal, Greece, Ireland and Ulster, and parts of Italy and Spain (1993 spending target ECU9.2 billion);
- reconversion of regions severely affected by industrial decline, including parts of the U.K., France, Belgium and Germany (ECU1.5 billion);
- combating long-term and youth unemployment (ECU1.8 billion); and
- accelerating structural change in agriculture and promoting rural development (ECU1.6 billion).

The bulk of this spending will be channeled through the regional and social funds. Other sources of EC development money include the agricultural fund (FEOGA) and the European Investment Bank (EIB), which provides medium- and long-term finance at market rates for industrial or infrastructure projects in backward areas. The Community also administers an Integrated Mediterranean Program to develop agriculture, rural industry and infrastructure in Italy, Greece, Spain and parts of France; and a similar special aid program for Portugal.

The European Regional Development Fund (ERDF) channels aid in the form of grants to member governments, mainly under a quota system that favours the Community's poorer regions. The overwhelming majority of funds are used to finance infrastructure projects in the designated areas, but some funds go directly to industry. Priority is given to investment in regions heavily dependent on agriculture or declining industrial sectors, or areas with a persistently high rate of unemployment.

Grants from the European Social Fund (ESF) are used to help finance training schemes throughout the Community, although special emphasis is placed on the long-term unemployed, job creation projects for young people, and retraining programs for workers in regions dominated by declining traditional sectors. All ESF spending is implemented via national government departments.

Major reforms of the structural funds have been agreed upon, to take effect from 1989; funding is to be better co-ordinated and funneled through a smaller number of multi-year integrated programs to increase its impact. Member governments are committed to the principle of "additionality," i.e., not to use the extra money from Brussels to cut their own budget outlays. The funds will work more closely with the EIB, so that projects can benefit from an appropriate mix of grants and loans. Regional and local authorities will play a greater role in project planning. And finally, project monitoring is to become more systematic -- including whether projects are complying with the EC's evolving rules on open procurement (see B.10).

Beyond this financial support, the Commission recently set up a Consultative Council of Regional and Local Collectivities to assure a continuous dialogue between the Brussels authorities and these entities regarding the Community's regional development policies. The aim is to head off any regional backlash against the EC's Single Market by bringing these entities more under the Community umbrella and turning them into committed Europeans. The new Council held its first meeting in December 1988, but accomplished little more than electing its president and board.

State aids

In addition to the doubling of Community funding, the governments concerned are arguing for a much more flexible policy on state aids, by which the peripheral areas can benefit from much higher levels of subsidies to compensate for the loss in protection via non-tariff barriers.

The Commission's policy on regional aids already recognizes the need for varying levels of subsidies. In the poorer regions, such as the Italian Mezzogiorno or Ireland for example, subsidies can amount to 100 per cent of the net value of investments, while in the central and most prosperous regions aid is limited to a maximum 20 per cent. So-called intermediate areas can benefit from 40 per cent incentives, while subsidies for projects in the border regions such as those between West and East Germany can receive up to 30 per cent of the investment.

It is clear that the Commission will be increasingly strict in monitoring compliance with these guidelines by the richer regions, and enforcing the obligatory reimbursement of illegal state aids. But it is unlikely that the Commission will become more lax regarding aid to the peripheral regions, either on the levels permitted or on notification requirements. Italy, for example, was persuaded last year to cut back aid levels to the more prosperous parts of the Mezzogiorno.

The recently published Inventory of State Aids (see B.5) highlights the fact that most of the subsidies spent by national governments have been lavished on dying sectors (such as steel, textiles, shipbuilding and coal), often located in the peripheral regions. This has clearly been unsuccessful in turning the concerned industries around.

B.7 LABOUR AND EMPLOYMENT

This whole area of Community legislation has until now been given low priority. Former Commissioner Lord Cockfield's white paper concentrated on free movement for goods and people but did not even mention labour rights. Indeed it was only following severe union criticism that the Commission in 1988 came up with its Social Dimension to the Single Market strategy. But even now Member States remain divided as to the role the Community should play in this area, so significant progress will remain slow in the near future.

The need for action in this area comes however from the simple fact that, to succeed, the strategy requires support of the unions and all national governments. But it is clear that in the short term completion of the Single Market will entail job losses of at least 500 000 due to the attendant industrial restructuring. Only once European industry has become truly competitive internationally will the Single Market start creating employment.

The Social Dimension

As a result of the criticisms and concern that the unions would instigate a Single Market backlash, in September 1988 the social affairs commissioner, Manuel Marin, launched the "Social Dimension," which provides a shopping list of directives and action programs that must be adopted by the EC if the Single Market is not going to lead to a deterioration in labour standards. It will not however do anything to prevent the job losses or stop the restructuring. The list ranges from a revised proposal on worker information and consultation through reinforced worker health and safety standards to a harmonized European work contract and flexible working time schemes.

Both the European Company Statute and the fifth company law directive are also mentioned, due to the inclusion of worker participation aspects in their provisions. But the fifth directive, which would introduce common structures for boards of directors, has been blocked at Council level for at least four years over this very question. And the Company Statute, even in its revised edition, is unlikely to win enough support in the Council of Ministers for adoption.

The proposals also underline the key role that the Social Dialogue must continue to play in the formation of EC legislation. The Social Dialogue brings together representatives of European unions and employers to agree to basic principles which would then be implemented according to the rules and practices in force in the individual Member States. The social partners have so far reached an agreement regarding the introduction of new technologies, in which informing and consulting with workers is recognized as necessary to success. This agreement, made in 1987, is to be the starting point for the Commission's work on a new directive on worker information and consultation. It should surface in the near future, as the Council of Ministers committed themselves to discussing this issue in 1989.

A previous proposal, known as the Vredeling directive after the Dutch commissioner for social affairs, Henk Vredeling, would have been applicable only to multinational companies. The current draft will affect all companies operating in the EC. But in view of the U.K.'s continued opposition to any European rules in this area, and well-known preferences in Italy, Germany, the Netherlands and Denmark for national practices, adoption is not for the near future.

The Commission is also working on a new proposal to cover all non-full-time work contracts. Previous attempts to push through directives on part-time work, temporary work and flexible working time failed in the face of clear British opposition and serious reservations by many other Member States.

Some progress is being made in the health and safety field. Draft directives regarding machine safety, worker exposure to visual display units, etc. are all slowly winning Council approval. They represent minimum safety standards, which most major MNCs already respect.

A key framework directive on worker health and safety was adopted in December 1988. It lays down minimum prescriptions concerning the prevention of professional risks, the elimination of accident risks, information, consultation and training of workers regarding potential risks. Although the directive concerns only "vital aspects" of worker health and safety, Member States have a full three and a half years to implement the provisions.

Freedom of movement

Once goods are free to travel unhindered across internal Community borders, the EC Commission may turn its priority attention to persons. The Rome Treaty guarantees free circulation for workers, but the Council has been very slow in approving mutual recognition of diploma directives, which represent the only way to assure respect for this basic principle.

It took Member States 17 years to approve a specific directive regarding degrees in architecture, but in December 1988 it did finally approve a general system of mutual recognition of higher education diplomas. This will affect all regulated professions that require at least three years of university education. Where the profession entails a precise knowledge of national law, a Member State may require either a training period or an examination.

Spanish prime minister Felipe Gonzalez stressed in a speech in December that "people must receive better treatment than goods" as they pass internal borders. And the Commission has just published a report regarding obstacles to unhindered passage of individuals across borders. In the past, any attempt by the Community to try and ease controls has met with problems over which it has either only partial or no competence at all. At the same time, however, all Member States have begun to realize that sporadic controls at internal borders are highly ineffective against terrorism, drug smuggling or whatever.

The Commission argues in its report for increased controls at the Community's external borders. The report is being discussed by an intergovernmental group of experts, known as the Trevi Group, set up to examine what can be done to co-ordinate Member States' actions against terrorism.

Dismissals

Member States and the Commission for the moment seem to recognize some job losses from 1992 as inevitable, so there is no movement to date regarding a reinforcement of Community rules on dismissals. Existing EC directives on collective dismissals or protection of employees' acquired rights in the case of a transfer of ownership could however take on increased significance. And certainly the Commission will continue to monitor implementation of these key directives. Moreover the EC's proposal regarding takeover bids (see B.2) would introduce a clear commitment to inform the shareholders and worker representatives about a bidder's intentions regarding the level of employment.

Industry perspectives

About half of service companies and a quarter of industrial firms surveyed singled out the free movement of personnel as a major benefit of the 1992 program, and expect that their human resources policies will be strongly affected.

This is of greatest importance to business services -- a group that includes accountants, law firms and engineering consultants whose staff will benefit after 1992 from the mutual recognition of professional qualifications. For similar reasons, among industrial sectors it is chiefly of interest to EDP and construction firms (Chart B7.1).

In personnel policies, the main priority is to develop pan-European management development programs. American and Japanese firms show the greatest interest in this effort, while European companies tend to focus more on increasing training budgets and language training. (As a small but aggressive Spanish metals company official mentioned during an interview, "What we need is trained salesmen who speak German!") While few companies see a need for standardizing labour relations procedures across the Single Market, more envisage harmonization of benefits packages. Some comments on this area:

- A French hypermarkets group: "1992 will accelerate the internationalization of our staff. By 1995, the head of at least one operation will be non-French, maybe several. In every country we will bring non-nationals into top management positions.

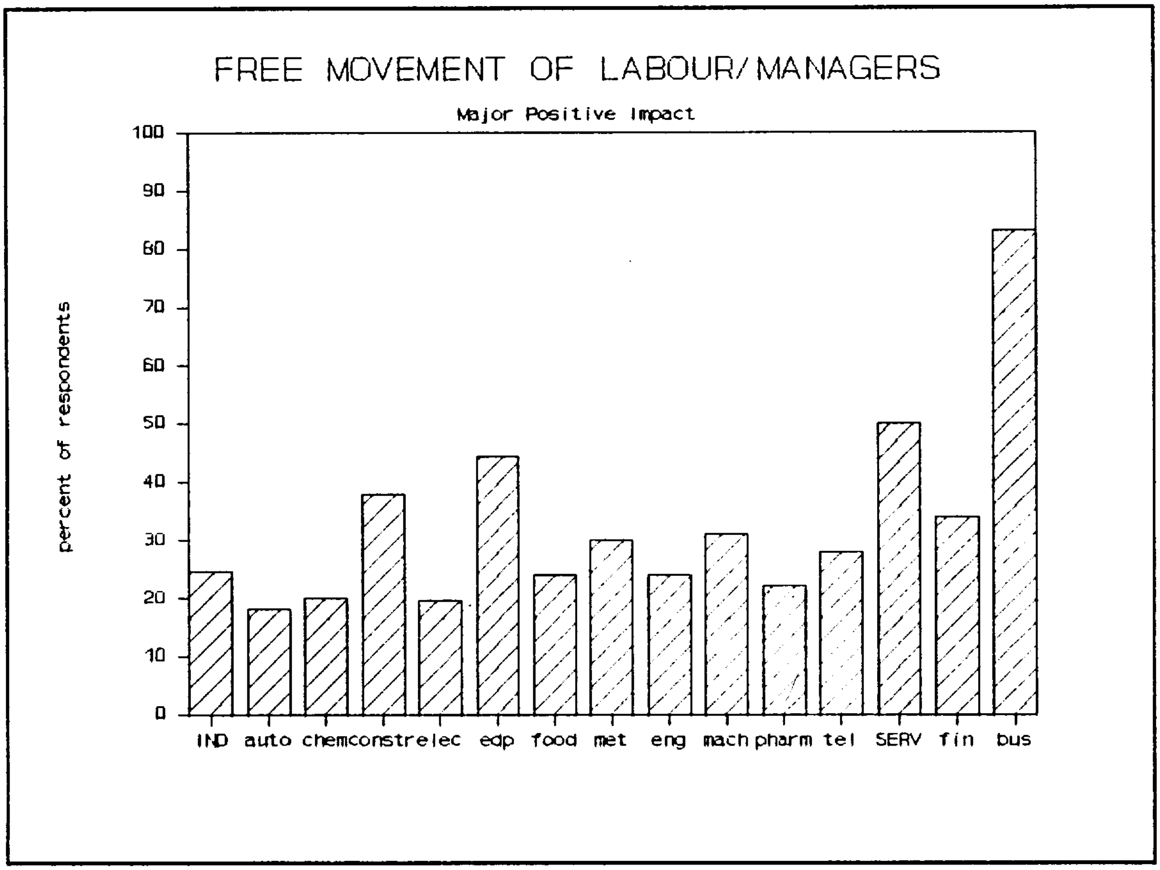
  "What language? That depends on how our markets evolve. If we develop in Asia, we will use English more. Our working language is usually the local language of the country. We speak English with the Chinese and in the U.S. Everyone in top management speaks English."

° A Swiss food company: "Our EC competitors will derive a lot of benefit from the free circulation of labour. We want to be able to send Swiss personnel to EC countries and receive EC nationals here for one or two years. But no Swiss work permits are available. And EC unemployment levels are so high that they object to non-EC personnel."

° A U.S. computer maker: "In the human resources area we will need more people with an international viewpoint. We now have more staff out in the field who have Europe-wide responsibilities and thus have developed wider horizons. But we will need even greater numbers in the future.

"However, training of such people still has a long way to go. For instance, in the U.K. and other countries engineers currently receive technical training but not the same education as liberal arts students. The universities will have to play a broader and more productive role in preparing people for these new European responsibilities."

CHART B7.1



As noted already, personnel issues are of particular importance to service companies. One of the most interesting comments came from ISS, a large Danish company with a world-wide business in industrial cleaning and security services:

"The rules for the European company will not present any problems for ISS. We have for instance grown a habit of naming employees to the board, even in countries where this is not demanded by law. And the sale of shares to employees at a favourable price was introduced everywhere two years ago.

"With 80-85 per cent of our costs being wages, we are intensely interested in the labour relations policies of the internal market, both the working environment and the education part of it. For our own part, in order to maintain a 12 per cent labour turnover each year -- very low in this kind of business -- we must make special efforts to keep the personnel happy. This has resulted in, among other things, our so-called Partner Project, and also in an open policy toward the public.

"The creation of the internal market will make us even more keen on openness, as it cannot be excluded that some competitors will grow, and the competition for qualified staff may grow more intense."

B.8 TECHNOLOGY DEVELOPMENT PROGRAMS

Concern for European industry's technological base is the prime motivation behind most of the Community's major R&D programs. The EC Commission illustrates the seriousness of the problem by explaining that, of the technological sectors of the future, 31 are dominated by the U.S., nine by Japan and only two by Europe: software and electronic switching.

So, even before the Commission launched its Single Market objective, it had announced plans to gradually increase spending on R&D from 3 per cent to 6 per cent of the Community budget during the 1990s, or about ECU5 billion annually. By comparison, national expenditures on research dwarf EC spending, having reached ECU65 billion in 1985. The EC's current R&D framework program entails total spending of ECU5.4 billion over five years (1987-91), with information technology, energy and telecommunications taking the biggest shares.

While the Community's role in R&D may appear small, it can be highly significant. Community programs not only serve to develop the research or technology itself, but also seek to co-ordinate national R&D and make national capitals aware of the serious duplication of efforts that makes European spending much less effective than in the U.S. or Japan, where R&D outlays reached ECU146 billion and ECU46 billion respectively in 1985.

The European R&D club

For European industry, as one French executive explains, the importance of the Community R&D programs may simply be in participating and becoming a member of the "club." European companies are talking to each other across the national borders -- a European network is growing, and failure to participate in it could represent a major loss at some later date.

In addition, European industry itself has called for preferential treatment to be accorded participants in European research programs. They argue that this is the only way to properly and rapidly amortize the initial investments. The Industrial Roundtable, representing heads of leading corporations in both the EC and EFTA, has suggested special tax treatment, accelerated processing at borders, public procurement preference for products developed under EUREKA (described below).

The Member States however have officially rejected most of these proposals as contrary to the GATT principles of nondiscrimination and national treatment. Nevertheless some type of de facto European preference system may well be operated.

Non-EC companies are theoretically welcome to participate in all the Community programs, provided they have something special to offer and their research is carried out at laboratories within the EC. This last condition is waived for EFTA-based companies.

But it should never be forgotten that the objective of all EC programs is to build internationally competitive European industries with technologies capable of combating U.S. and Japanese rivals. Participation by a foreign firm will therefore have to entail research or a technology that is clearly lacking in Europe. In other cases preference will always be given to the participation of a European firm.

EC collaborative R&D programs

There are a multitude of EC R&D programs with catchy acronyms in such fields as new services (DRIVE, DELTA, AIM), biotechnology (BAP, BRIDGE), food technology (ECLAIR), thermonuclear fusion (JET) and so on. But the key four in the industrial field are: ESPRIT for information technology, RACE for telecommunications, BRITE for manufacturing technologies and EURAM for advanced materials.

Attempts by the Commission to launch an aeronautics research program have run into stiff national opposition, but the plans have not yet been totally scuttled. In December 1988 research ministers approved the launching of an ECU35 million pilot program in this field. The funds will come from BRITE and EURAM (described below) and will be devoted to subjects such as fuel efficiency and new materials. If the Commission has its way, this pilot program will pave the way for a much bigger full program.

- <u>ESPRIT</u>, the information technology program, was officially launched in 1984 after a brief pilot phase. It was designed to last at least 10 years, but due to accelerated spending during the first phase, the second five-year term began in December 1987. While financing for the first term was set at ECU750 million, the second term benefits from a doubling of spending to ECU1.6 billion. The second phase concentrates on microelectronics, information processing systems and IT application technologies.

The first phase involved 219 projects and roughly 450 different companies, universities and research institutes. ESPRIT II will involve some 500 researchers and at its peak will represent about 30 per cent of all European precompetitive R&D. As in the other joint R&D programs, the EC underwrites a maximum 50 per cent of the spending with the companies or universities providing a matching 50 per cent.

- The purpose of RACE is not to catch up with Europe's competitors, but to maintain the EC's existing competitive edge in the telecoms sector, which will represent 7 per cent of Community GDP by the end of the century compared to roughly 2 per cent now. The full RACE program runs from 1987-91 with a total EC contribution of ECU550 million.

  RACE's general goal is to enable the Community to replace existing digital telephone systems with integrated broadband communications (IBC) based on ISDN, or integrated services digital networks. This system would permit the simultaneous transmission of voice, data and image on the same network and would be able to handle a wide range of new and conventional services including telephones, videophones, cable and pay television and electronic mail.

  The first phase involves further work on the IBC reference model, research on IBC technologies, hardware and software (opto-electronic equipment, audio and video signal processing, etc.) and finally the simulation and testing of IBC techniques.

- BRITE, launched in 1985, was the first of the "second generation" of EC R&D programs, in that it represents an application of information technology to a specific sector: in this case manufacturing. ECU400 million has been set aside in the Community's budget for BRITE.

  The jointly financed program covers research into nine key sectors including wear and deterioration, laser technology, joining techniques, new testing methods, and computer-aided design and manufacture (Cad/Cam).

- The EC is spending ECU220 million on EURAM, which is designed to help European industry develop and produce for itself a whole range of sophisticated materials that it currently has to import or manufacture under U.S. or Japanese licenses. It covers the full range of advanced materials, including metals such as titanium alloys and superplastic forming techniques, engineering ceramics and composites.

EUREKA, launched in 1985 on French initiative, is an intergovernmental affair linking 19 EC and EFTA countries plus Turkey. Although the Commission is also a member, it does not manage or fund the program. EUREKA's role is to act as a catalyst to major trans-European development projects, such as high-definition TV and semiconductor development. In both these cases it carries EC research one step further toward the market than do ESPRIT and similar programs focusing on precompetitive research. By mid-1988 EUREKA had generated over 200 projects representing aggregate investments of about $1.6 billion.

Standards

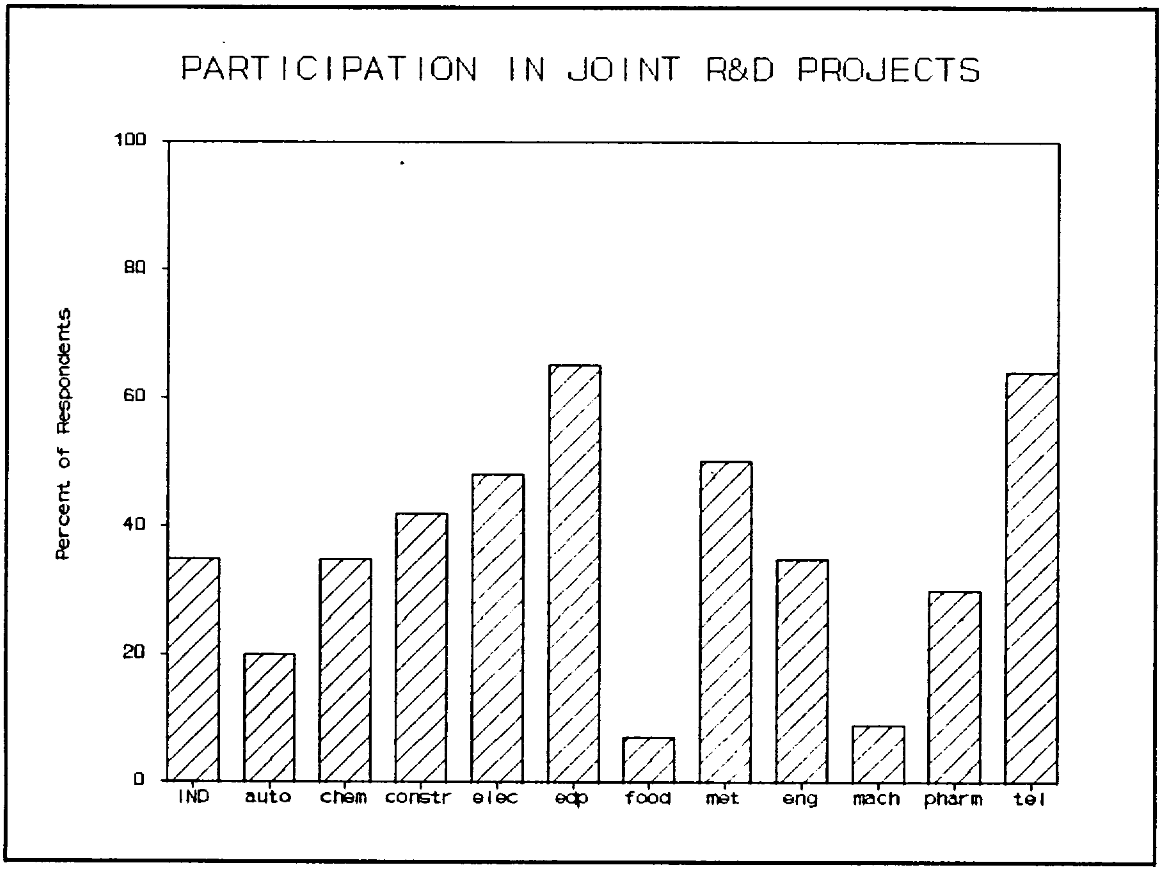
Central to the EC's efforts in R&D lies a related policy on the development of European standards in both telecommunications and information technology (see B.5).

Launched in 1985, the Community's policy in this area is designed to encourage the harmonized application of international standards in the 12 Member States. The main thrust of this policy is to promote standards defined by reference to the OSI or Open Systems Interconnection model of the International Standardization Organization (ISO). However, ESPRIT and RACE have been active in standards development, with 28 projects having led to the development of key standards.

Industry perspectives

Of the industrialists responding to the business impact survey, 35 per cent that their companies planned to participate in joint R&D projects such as EUREKA or ESPRIT. The proportion was highest among EC and EFTA firms (42 per cent), but 25 per cent or more of American and Japanese multinationals also hoped to get involved. The industry profile reflects the priorities of the R&D programs as discussed above, with the greatest interest in EDP, telecoms, metals/minerals and electronics (Chart B8.1).

CHART B8.1



Three examples of what EC and non-EC companies hope to gain from R&D collaboration:

- A leading Danish computer systems supplier, Soren T Lyngso, is reorganizing in preparation for 1992. The problem facing Lyngso is that it has a range of sophisticated hi-tech products but lacks the "critical mass" to realize the full potential of its product portfolio. By pursuing the co-operation route, it aims to find partners who can help build its businesses into effective competitors worldwide.

  Lyngso is already participating in EUREKA projects, one of which has led to the establishment of a promising new business unit dealing with artificial intelligence. However, the company regards the main advantage of such joint R&D deals as being the gains its research personnel will derive from operating in the international sphere as they interact with researchers from different countries and disciplines.

- A U.S. computer maker sees R&D co-operation as a way of learning more about European companies in its industry. "We joined several pan-European co-operative programs -- ESPRIT, RACE and AIM -- that are financed 50/50 by the EC and industry. Over the past three years we have learned a lot. It's been good training for management, which has become receptive to co-operating with other companies in the industry. In fact, the initial co-operation has crystallized into a number of other joint activities, especially in Italy. It's like dating before marriage; if you like the partner you go ahead with a deeper involvement."

- A Japanese trading company is interested in the joint R&D programs, "but I think they are difficult to join. Many European governments are trying to protect their own industries ... and also European companies. I'm not sure whether the EC will accept the joining of Japanese companies.

"Some Japanese companies are trying to acquire small European manufacturers which they could use as a tool to join. For example, we are trying to buy a small European factory which was working as a subcontractor for Philips. This connection could be useful...."

B.9 ENVIRONMENTAL CONTROL

Environmental protection is now among the explicit goals of the Community, inserted in the Rome Treaty as amended by the Single European Act. In practice, Brussels has been actively involved in this area since 1973, when the first four-year Environmental Action Program was launched, and over 100 environmental directives are already in force. Today, growing public concern over water, forests and the global climate -- reflected in the spread of Green parties or pressure groups in most Member States -- is lending new prominence to environmental issues.

A number of measures under the Single Market program are directly related to environmental concerns, among them directives already adopted requiring environmental impact assessments for major investment projects, and setting timetables for gradual reduction of gaseous emissions from large combustion plants and motor vehicles. A pair of directives proposed in 1988, covering the contained use of genetically modified organisms and their release into the environment, are designed to provide the legal security needed for development of the biotechnology sector in Europe. And in early 1989 the Commission will issue its proposals for a directive on the introduction of civil liability for environmental damage; this will basically render obligatory the principle that "the polluter pays" whether or not there has been negligence. (For more on these directives, see Appendix I.)

As the other barriers to intra-Community trade are eliminated and the "level playing field" becomes a reality, it is clear that differences in environmental protection will have an increasing effect on competition. However it is unlikely that long-term investment decisions will be greatly influenced by purely environmental considerations -- i.e., a more flexible approach currently prevailing in a given country. The heads of state and the Single European Act recognize the need for high standards of environmental protection, and eventually Europe will introduce them. Member States with less rigid standards will then have to catch up. In the shorter term, it is not clear how much emphasis will be given in Brussels to environmental issues.

Problems with harmonization

As in other areas, the natural tendency will be toward "upward harmonization" as common standards are aligned largely on those countries with the strictest national legislation. In some measure, however, Community environmental standards will continue to reflect the North-South divide within Europe, and to this extent they will often lag behind environmental legislation in other developed countries. The northern EC countries will argue for tighter rules, but the underdeveloped south will permit adoption of only minimum standards.

Article 100A of the revised Rome Treaty (inserted by the Single European Act) provides the first hint of this divide by allowing Member States to opt out of EC legislation if pre-existing national rules go further.

This provision has been buttressed by a key ruling by the Court of Justice which will play an important role in the future development of EC environmental policy. In 1988 the Court upheld Denmark's right to maintain strict requirements for bottle recycling, despite the Commission's complaint that the law represents an illegal barrier to intra-Community trade. The Court determined that in this case national concerns for protection of the environment could take precedence over the free circulation of goods.

In an effort to limit the potential havoc that this ruling could have on the Single Market, the Commission is appealing to the Court of Justice against incentives the Dutch government plans to offer for the purchase of small cars that satisfy emission controls even stricter than those adopted by the Community in November 1988. The Commission and most Member States argue that such incentives risk distorting competition and preventing the creation of a Single Market in automobiles. There is also concern, particularly from the French industry, that the Dutch incentives will promote the purchase of Japanese cars.

Nevertheless, the Court's ruling on Danish bottles could be used to force other Member States to go a bit further when adopting common environmental standards, to avoid the risk of certain countries going much further on their own to the detriment of the Single Market.

Industry Perspectives

The advance of environmental legislation is at once a problem and an opportunity for European industries. While forcing companies to invest heavily in cleaner technologies, it is also promoting the development of new "environmental markets" for private-sector products and services including water and waste management, air pollution control, etc. A recent study by the French research group BIPE (*European Environmental Markets*, Paris, 1988) puts the total value of these markets at ECU40 billion in 1987 (Germany 14.6 billion, France 7.7, U.K. 6.9, Italy 4.7, Spain 1.2).

For the energy sector, public concern over the real or supposed impact of different forms of energy -- the risks of nuclear power, the high cost of pollution control in coal-burning stations, and the much-discussed greenhouse effect -- will influence significantly the selection of electricity generation methods.

Environmental considerations are also affecting consumer goods markets. In Germany, for example, the "environment" label has helped sales of many products ranging from clean-running cars to non-CFC aerosols or quiet lawnmowers. Some 2 500 products are now being sold under the "environment-friendly" label. The completion of the Single Market should accelerate this trend.

A French executive interviewed for this study sees a big difference between German and French attitudes on environmental questions:

> "The Germans are really polarized on this, obsessed with pollution, acid rain, auto exhausts, protecting the forests and all that. But German industry, as always, they see this in terms of potential markets -- new products, new techniques and production possibilities. For the French, a priori they are more reticent. They see the environmental cocktail as a constraint, the Germans as an opportunity."

An Italian chemical company, which has been under fire for some time as an environmental polluter, says the group has "learned a lot from its mistakes" and is now developing a business in the sale of clean and safe technologies. "Aside from being good for our overall corporate image, the ultimate consideration is it's good business."

Another company that expects to benefit from tougher environmental standards is the Danish industrial cleaning firm ISS. As a company spokesman explains:

> "The internal market will introduce hygienic standards in for instance food production. Here ISS should be in a favourable position, as slaughterhouse cleaning is one of our specialties, and we have competed on offering the highest possible quality. Some existing rules for slaughterhouses are even stronger than those for hospitals (which ISS also serves). Our company policy has been to extend the highest quality demanded -- mostly in the U.S. -- to the rest of our companies in other countries.
>
> "As I see it, the stiff demands to qualify will make it prohibitive for a number of smaller firms to participate. In this field the internal market will turn out to be a heaven for big companies, a closed country for small ones."

B.10 PUBLIC PROCUREMENT

With national purchasing contracts totaling ECU530 billion in 1986 -- equivalent to roughly 15 per cent of the Community's GDP -- their liberalization could play an important role in stimulating European economic growth through greater competition. In recognition of the key role public procurement markets play, EC heads of state have repeatedly called on the Commission "to make substantial progress in this area in the interests of the Community as a whole."

This clear political backing, however, has not yet filtered down to the national administrations, which are responsible for implementing policy. Indeed former commissioner Lord Cockfield charged that all Member States misapply even the existing directives and that as a result markets have remained essentially national preserves. Statistics show that at least 75 per cent of all national tenders go to domestic firms, and in some sectors the figure is much higher. Despite this fact the Commission has launched new initiatives to extend the scope of existing liberalization directives to include the telecommunications, water, energy and transport sectors.

Liberalization efforts

The two existing directives cover public works and public supply contracts and date respectively from 1971 and 1977. These measures, applicable to all supply contracts over ECU200 000 and works contracts over ECU5 million, introduced basic requirements regarding notification and attempted to restrict Member States' use of emergency or single tendering procedures. As the 75 per cent figure shows, however, their success in opening these markets has been minimal.

As a result, the Council of Ministers in 1988 adopted major reinforcements of these rules, aimed at increasing the transparency of tendering procedures via longer notification periods as well as increased publication requirements; for example, details of the winning contract must now be published. In addition, European standards (where they exist) will generally prevail over national ones. Limited regional preferences for local suppliers or contractors in high-unemployment areas will have to be phased out by the end of 1992.

Meanwhile the Commission has tabled proposals to liberalize the four so-called excluded sectors: telecommunications, water, energy and transport. In all cases the EC seeks to introduce transparent tendering procedures and does not attempt to set any minimum percentage of contracts going to non-national bidders.

The telecommunications proposal calls for a progressive opening of equipment contracts: 70 per cent during the first year, leading up to total liberalization by 1992 if all goes on schedule. The other three sectors are covered by totally new legislation as well and are not simple additions to existing directives.

EC experts explain that the need for separate legislation in these four areas stems from the different nature of the entities involved: "Existing legislation is directed at civil service administrations, while the new rules are written for sectors which are much more business-oriented in their purchases and procedures." The measures will apply not only to industries directly under government control but also to enterprises operating under state concessions. The proposal provides a full list of all undertakings and activities affected by the proposed rules, which include railway companies, ports and airports, electricity and gas suppliers, oil and gas extraction enterprises, and providers of telecommunications, water and municipal transport.

Due to the different nature of the targeted contracts, the Commission has adopted a much more flexible approach to deregulation than in existing legislation. In practice this means purchasers have several options for placing tenders. They may call for bids for each contract or periodically seek "expressions of interest" from would-be suppliers and contractors. Or, they can maintain a pool of qualified suppliers and contractors provided the conditions for entering into this pool are objective and applied in a nondiscriminatory way.

Reciprocity

If the Community goes through with these proposals -- adoption will involve a major battle with the Member States, who will argue in favour of their traditional buy-national approach -- it will have the most open public tendering procedures in the world. But here again, the

Community wants other countries to open their own national markets in exchange for access to the liberalized EC market. As a result, the problem of reciprocity will play a key role in extending the benefits to third countries. An EC official stressed that "whatever we do it will be in strict compliance with the GATT."

As currently drafted, the text would allow the concerned entitites affected by the rules to be free to choose the best bid regardless of nationality; but where offers are equivalent, Community preference can be invoked to exclude bids with less than 50 per cent EC content. According to an EC official, however, this prerogative "may be modified or even eliminated via GATT negotiations."

The standstill proposal

An essential mechanism in the Commission's fight to open up public procurement markets is its 1987 proposal for preventive intervention or a standstill authority. This was amended significantly in December 1988 to meet European Parliament criticisms. The amendments serve to limit the Commission's powers of suspension.

Under the amended proposal, when the Commission determines that a Member State is not respecting EC tendering rules, it can suspend the award procedure for a maximum three months provided the contract has not yet been definitively concluded. The amendments include an exhaustive list of the four instances where the Commission can suspend an award procedure -- e.g., failure to publish a tender notice in the EC's Official Journal, or when a supplier has been excluded from participation in the tendering procedure in violation of Community rules.

Article 90 in telecoms

Parallel to its more traditional efforts to open public procurement markets, the EC Commission has used its authority under Article 90 of the Rome Treaty to force deregulation in the telecommunications sector. During 1988 it issued two Article 90 directives aimed at forcing the national PTT authorities to end their exclusive rights or monopolies over the supply of telecoms equipment and services by 1991. Voice telephony and telex are excluded from the services directive.

Article 90 allows the Commission to issue directives on its own authority without Parliamentary debate or Council approval. It also obviates the need for the Commission to take Member States one-by-one before the Court of Justice to ensure the application of competition rules to public undertakings or to those for which Member States grant "special or exclusive rights." Article 90 can be applied only in these cases.

While France, Italy, Belgium and Germany all claim to support the objectives of the equipment directive, they oppose the use of Article 90 to achieve them. They argue that objectives of such importance for the entire Community should be subject to the normal legislative procedures. As a result they have complained to the Court of Justice. The Commission however is pushing through with its rules while awaiting a judgment sometime in the next two years.

Whatever the outcome, Member States are slowly realizing they are fighting a losing battle over PTT monopolies. Once again international competitiveness requires a European springboard for their industries, and the national-champion approach to preserving PTT markets is undermining this strategy.

Defence procurement

EC countries are moving toward common defence procurement policies, but progress will be slow. The moves will come via NATO's Independent European Programme Group (IEPG), reinforced by the Single European Act which brings defence into the domain of EC political co-operation and pledges Member States to maintain "the technological and industrial conditions necessary for their security."

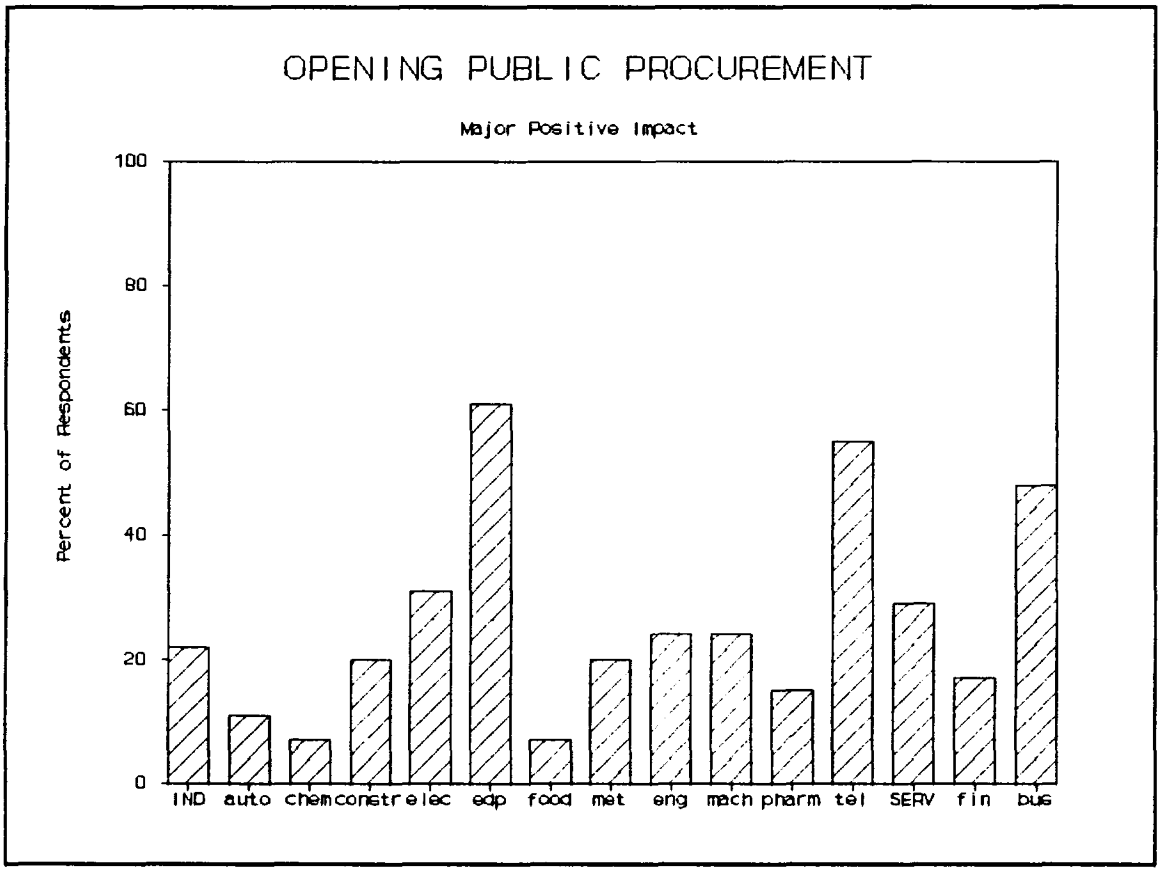
In a first crucial step toward common defence procurement, the 13 European NATO states who are members of IEPG agreed in November 1988 to exchange information about forthcoming arms purchases. In this way firms could bid for contracts in other countries. Defence ministers further approved in principle the setting up of a permanent IEPG secretariat, as well as a panel on co-operation in defence research. Defence trade flows will also be monitored between members to ensure that countries obtain a fair return on opening their contracts to other countries.

While the infrastructure is being laid for general defence procurement co-operation, intergovernmental collaboration on specific joint weapons projects is already long entrenched. In the latest example, four EC countries -- the U.K., Germany, Italy and Spain -- have agreed to go ahead with the almost $10 billion initial phase for development of a European fighter aircraft.

Industry perspectives

Opening up government procurement is of particular interest to EDP and telecoms suppliers, as well as to business consultants (Chart B10.1). On the other hand, only 20 per cent of construction firms were enthusiastic about this, and 10 per cent saw it as a serious threat. This is another area where few businesspersons predict rapid liberalization, however; the majority expect the impact to be felt only in the late 1990s.

CHART B10.1



Some comments from different industrial sectors:

- A spokesperson for ENI, the Italian state energy holding, says ENI favours opening up procurement and is satisfied that this is being extended to the energy sector. "However, the regulations on the matter give a strong competitive advantage to private companies, while state companies are compelled to adopt slow and complicated procedures."

- A major EC producer of high-tension power cables also expects to benefit. "Government procurement practices will change substantially beyond 1992 -- maybe not exactly in 1992, we know there are bound to be delays, but soon thereafter things will change. We have to make sure we have a strong foothold throughout the Single Market. You can't expect to supply major government requirements from outside."

Acquisitions are seen as a way to strengthen the company's presence in certain markets. "Our major competitors have been doing the same. People are looking at small producers who are well acquainted with the local procurement market, companies that know the ropes and have the right connections.

"For awhile the big government orders may continue to go to local companies -- not so much because of entrenched nationalistic feelings but because, while it is true that people like ENI will accept bids from non-Italian suppliers, its specifications will not change all that much, and in general manufacturers that are on the ground already and that have the expertise and experience to comply with the kind of requirements made by a certain customer will continue to have the edge."

- In telecommunications, a U.S. supplier is counting on demand from the end-user to overcome the PTTs' buy-national instincts: "The business customer, who's going to be called on to compete as he's never had to compete before, needs world class communications -- so he won't tolerate anything that keeps him from getting the kind of communications he wants. If he doesn't get them, it's going to be like having one hand tied behind his back. Those forces are only beginning to be heard, but they'll be heard loud."

- A French aerospace company: "As far as public procurement goes, 1992 is not a magic dividing line. Obviously, well-established links between public administrations and national suppliers will endure. But there will gradually be greater European cross-purchasing. For both states and companies, co-operation and cross-purchases will be easier when new products rather than already existing ones are involved."

- A Swiss defence supplier: "I cannot imagine that the present protection of home defence industry production will change to allow greater penetration by outside companies. So we will continue to tackle this problem by establishing co-operative agreements with companies within the EC."

B.11 TAXATION

Taxation is one area where the Community is dragging far behind in its Single Market objectives -- partly because Council decisions in this area must be unanimous. However, 1989 could see a major breakthrough on both the indirect and direct taxation fronts. Not only is a revised VAT proposal expected from the new tax commissioner Christiane Scrivener, but the Spanish government, which occupies the Council presidency from January to June 1989, has identified a package of three corporate tax directives as a priority for adoption.

Value-added taxes

Signs of a new VAT proposal are taking shape. But a more precise outline of the Commission's intentions was not expected to emerge before February 1989, as Scrivener was to be focusing until then on the more urgent question of taxes on savings income (see below).

The 1985 white paper on completing the Single Market identified the varying rates of VAT and excise taxes as the major reason for continuing border controls on intra-EC trade. As a result their harmonization represents a key objective of the white paper strategy.

In 1987 the then internal market commissioner Lord Cockfield proposed to limit the number of VAT rates to two: a normal rate ranging from 14 per cent to 20 per cent, and a reduced rate of 4 to 9 per cent which would be applicable only to basic necessities. Excise duties on alcohol, fuel and cigarettes would be set at fixed rates.

These proposals are viewed by most Member States to be as controversial as the 1968 introduction of the VAT itself. Governments currently operate anywhere from one to five rates, running from zero to 33.5 per cent, and there is little harmonization regarding which rate applies to which products. Countries with high rates, especially Denmark, would face heavy revenue losses under the Cockfield plan, while in Britain the Thatcher government is pledged to maintain the U.K.'s zero rating on food and children's clothing at all costs.

Of concern to industry is a VAT clearing system which would apportion VAT revenues to appropriate Member States. It is seen as an additional bureaucratic burden, a disguised fiscal control, and in view of lack of clarity with regard to suggested settlement procedures, as not clearly workable.

Faced with these attitudes, the new Commission is likely to bring forth a revised proposal incorporating bands for excise rates and a modified normal rate, possibly even setting a minimum level of 17 per cent or so and leaving Member States to determine how much higher they want to go. The fate of the reduced rate could be influenced by the outcome of an upcoming debate in the Parliament, whose Economic and Monetary Committee has proposed a reduced rate band running from zero to 6 per cent.

Meanwhile the British government is preparing its own alternative solution, which is based on the theory that to eliminate the problematic border controls, governments could simply carry out their VAT checks on the premises of registered traders.

The Industrial Roundtable for its part has come out in favour of the Community setting a single minimum tax rate. In a recent report entitled "Opening Up the Tax Frontiers," the business leaders argue that "Community action is required to prevent countries setting a tax rate below that of their neighbours in order to benefit from cross-border shopping. A minimum tax rate is required, leaving national governments free to set a tax rate above that if desired."

Direct taxation

Direct taxation is not part of the Internal Market White Paper strategy. But industry has pushed for parallel developments in this field, fearing that as Member States' freedom to manipulate VAT rates is decreased, national governments would turn toward direct taxation. Currently the only EC legislation in this field concerns a recommendation regarding mutual assistance among the tax authorities.

A breakthrough in the long-pending package of three directives could, EC officials hope, "get the ball rolling in the whole area." This trio comprises a 1969 proposal on the

arrangements applicable to parent and subsidiary companies in different Member States; a 1969 draft on common tax arrangements applicable to cross-border mergers, scissions (divisions), etc.; and a 1976 proposal introducing
an arbitration procedure to avoid double taxation in the event of disputes between tax authorities over transfer prices between associated enterprises.

The package has been blocked at Council level for almost four years due to a disagreement with Germany over the level of withholding tax it may charge in the parent-subsidiary directive. This proposal would abolish double taxation of dividends distributed by a subsidiary to its parent established in another Member State, as well withholding taxes levied by the subsidiary's country.

National experts are now discussing a compromise solution in which Germany will reduce its withholding tax to 5 per cent by 1992 rather than maintain it at 20 per cent as it had been demanding. Since the Spanish presidency has identified corporate taxation as one of its priorities, the Commission is "moderately optimistic" about the chances of an early decision. A planned modification in Germany's domestic tax system has permitted the change in its position.

Although EC officials recognize that there is no direct link, progress on this package could ease the way for a key proposal aimed at harmonizing the corporate tax base. This proposal, which should be forthcoming in early 1989, will cover the whole set of rules for determining taxable profits, including depreciation, capital gains and stocks, etc.

Once the corporate tax base is harmonized, the Commission may try to resuscitate a proposal dating from 1975 aimed at "approximating" corporate taxes themselves to a band of 45 to 55 per cent. The European Parliament refused to provide an opinion on this proposal until the Community had first examined the corporate tax base.

In 1986 the Commission proposed a directive harmonizing rules regarding the carrying forward and back of losses, but the Council has not yet considered it.

Taxes on savings

The most urgent tax priority for the new Commission is to prepare its proposal on harmonization of withholding taxes on interest income. This was promised last June, when the 12 Member States committed themselves to remove the last remaining controls on short-term capital movements by mid-1990 (see B.12). At that time the Commission was enjoined to submit to the Council of Ministers "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." These proposals were due at yearend, and the Council is supposed to take a common position on them by mid-1989. As with other tax issues, however, any decision by the Council must be unanimous.

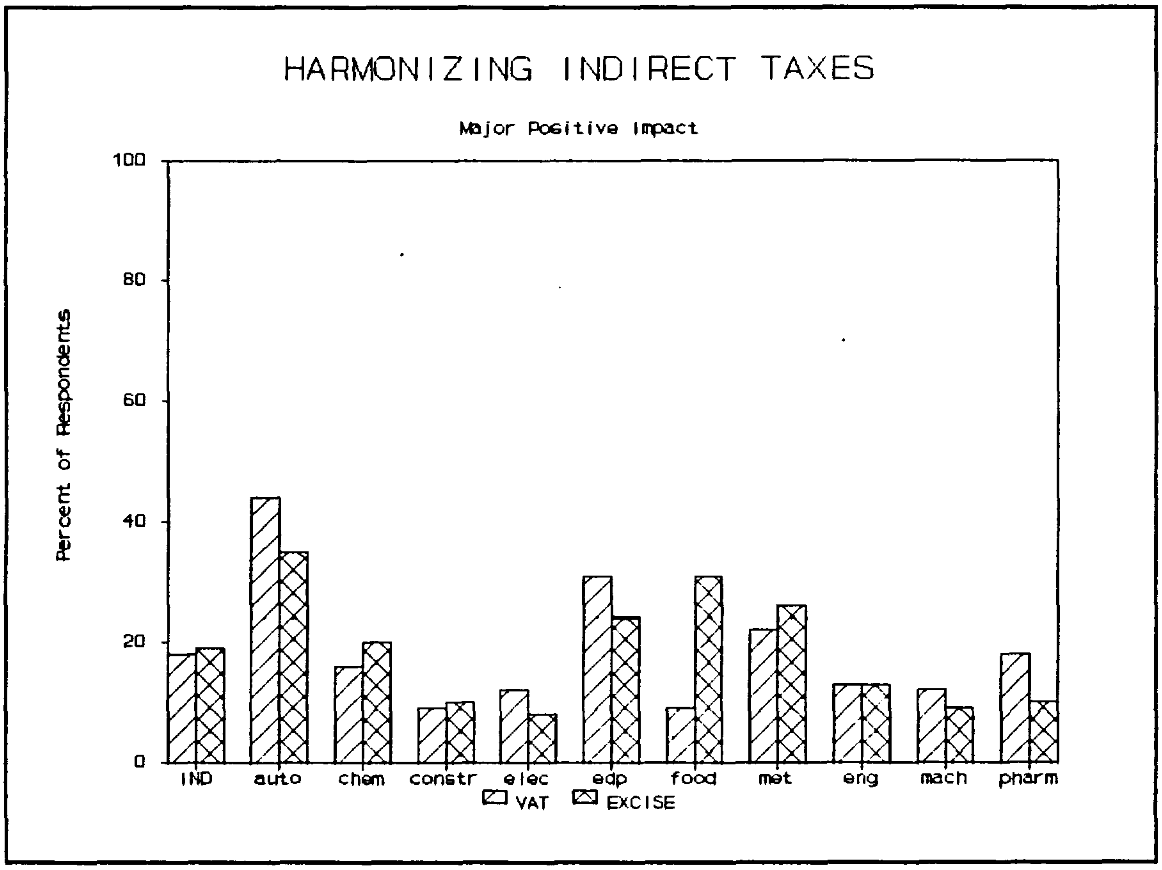
The aim was to calm French fears that lifting exchange controls will lead to massive tax evasion as citizens move savings to more fiscally advantageous Member States. At home, French residents face a 46 per cent withholding tax (partly reimbursable to lower-rate taxpayers) on income from savings and term deposits, and 27 per cent on bond income. Moreover, banks in France are obliged to declare to the tax authorities all the interest income they pay out. By contrast, Luxembourg levies no withholding taxes on interest income to nonresidents, and its banks are under no obligation to report such payments (apart from France, only Denmark and the Netherlands impose such requirements).

The Commission's proposal should therefore cover the taxation of interest and dividends as well as closer co-operation between tax administrations. The best hope for agreement would seem to lie with the idea of a generalized withholding tax, albeit at rates well below those now prevailing in France. A decision will not be forthcoming easily, however, especially in view of the unanimity requirement. But some agreement on the handling of this tax issue, while not a formal precondition for the full liberalization of capital movements, could well be a de facto one.

Industry perspectives

Harmonization of indirect taxes is mainly of interest to the automotive, EDP, food/beverage/tobacco and metals/minerals sectors (Chart B11.1), as well as retailers and oil companies (some of whom see this as a negative factor). But few of the respondents to the survey expect harmonization to materialize before 1995-2000.

CHART B11.1



In the auto industry, the Commission's proposals on VAT harmonization are seen as a major benefit of the 1992 program. At present, VAT on new cars is levied at widely varying rates, ranging from 6 per cent in Greece to a maximum of 38 per cent in Italy (on cars of over 2 litres engine capacity). The Commission's original proposal of a 14 to 20 per cent rate band would require sharp reductions in France, Spain and Belgium. While finance ministers are reluctant to sacrifice revenues, the alternative would be chaos for the industry. As a Peugeot executive states:

> "In theory, any consumer will be able to go anywhere in the EC, buy a car with a lower VAT rate and bring it back. Now, France has a VAT rate on cars of 28 per cent, but the rate in Germany is 14 per cent, in Italy 18 per cent and the U.K. 15 per cent. The French authorities will be forced to change the rules and harmonize the rates."

The industry is also concerned about differences in excise taxes. One type of levy that does not constitute part of the Commission's internal market program is car purchase taxes, which are levied in six of the 12 Member States, in some cases (Portugal, Greece, Denmark) at very high rates. These can have a greater market distorting effect than divergent VAT rates, influencing market segmentation (the type of cars that are bought), replacement and new demand, and the profits that manufacturers can gain.

Some companies in other industries are also impatient for indirect tax harmonization:

- Germany's Bayer: "For the German chemical industry, an important issue in tax harmonization is the structural change in excise duties on alcohol and mineral oil. Also VAT on pharmaceuticals: most other countries levy the lower VAT rate on pharmaceuticals, while Germany places the full VAT of 14 per cent on them."

- An Italian chemical industry consultant: "The tax picture also needs to be adjusted if products are to really move freely from one country to another. The VAT levels are particularly different vis-à-vis pesticides; they go from a low of 6 per cent in

Holland to an incredible 22 per cent in Denmark. Obviously the disparity in VAT from country to country affects prices and marketing of these products. But I think any substantial agreements are still far away, given the need for unanimity on tax changes."

- A major U.K. beverage company is dismayed by its own government's resistance to harmonization of excise taxes on alcohol. "Without that, there won't be any Single Market for us."

B.12 FINANCE AND BANKING

Harmonization of the finance and banking sectors is viewed as a necessary foundation for the free flow of goods and capital throughout the EC. Both the EC Commission and the Council of Ministers have made significant progress in this direction, but the most controversial proposals -- which seek to introduce single EC licences in banking and investment services -- must still be adopted by ministers. Nevertheless Member States have realized that, as in manufacturing, financial services require a European-sized home base to be internationally competitive.

Progress in this area regularly raises the question of the need for both a European central bank and a common currency. The Delors Committee, set up in 1988 to examine what is possible on this front, will make its report during the meeting of Heads of State scheduled for June in Madrid.

Meanwhile the European Monetary System (EMS) continues to function, keeping exchange rates within certain margins, and private use of the ECU continues to grow (see below). But the fact that sterling remains outside the exchange rate mechanism prevents the EMS from taking on the political and economic clout the system could have.

Freeing capital movements

The liberalization of markets for financial services is linked to the removal of remaining exchange controls on capital movements. In June 1988 the Council adopted a landmark directive by which complete freedom of capital flows will become mandatory from July 1, 1990, except for the four poorest Member States -- Spain and Ireland can delay action until end-1992, Greece and Portugal until 1995. Importantly, this liberalization covers capital flows not just within the EC but worldwide, since it would be technically impractical to maintain controls on flows to or from non-EC countries unless all EC members were to do so.

The directive will also require Belgium and Luxembourg to scrap by the end of 1992 their joint two-tier exchange rate system in which trade-related transactions benefit from a stronger franc. In the meantime, however, the Council called on the two governments to manage the system so that the rates applied to the free and commercial markets do not differ significantly nor for a long period of time.

The short-term capital movements freed by the directive cover a bank's ability to lend its domestic currency to nonresidents, investments in short-term securities, financial loans and credits, as well as the ability for all EC citizens to open private bank accounts in other Member States. Medium- and long-term capital movements associated with commercial transactions, acquisition of shares and bonds and long-term investments are already free throughout the EC. As the U.K., Germany, Belgium, Luxembourg and the Netherlands have already freed short-term movements, the major impact in the next two years will be felt in France and Italy.

To calm French fears that decontrol will lead to massive tax evasion as citizens move savings to more fiscally advantageous Member States, the 12 ministers committed themselves to consider urgent proposals from the Commission for harmonizing withholding tax systems on savings income (see B.11).

The directive also contains a safeguard clause which will permit controls to be reintroduced on short-term capital movements if "exceptional" flows seriously disrupt a Member State's monetary or exchange rate policy. While Member States may take such action without prior authorization from either the Commission or the Council of Ministers, the Commission will have post facto control including the right to amend the measures, which can remain in force for a maximum six months. Finally, a revamped Community loan mechanism of ECU16 billion is provided for countries in balance of payments difficulties.

Banking

Piece by piece the Community is moving toward its key legislation in this sector: the second banking directive, which will introduce a single banking licence valid throughout the Community via the principle of mutual recognition. The Commission submitted its proposal in January 1988. In preparation, the EC is first trying to harmonize solvency ratios and "own funds" or capital adequacy requirements, which together will create minimum prudential requirements and thus open the way for the single banking licence.

In December 1988 the Council took its first step, adopting a common position on a harmonized definition of own funds -- listing in detail just what a bank can include in its calculation of capital.

Own funds serve to ensure the continuity of credit institutions and to protect savings; they are an important measure for the supervisory authorities in assessing the solvency of credit institutions. Under the EC directive, banks may include items ranging from capital plus share premium accounts to reserves, and must deduct from their capital base intangible assets, material losses and holdings in other credit institutions that amount to more than 10 per cent of their capital, etc. In order to avoid distortions of competition, public credit institutions may not include in their own funds guarantees granted them by the national or local authorities (due to this provision, Belgium alone has until 1994 to bring its legislation into line).

In most respects the rules follow the definition agreed to by the so-called Basel Committee of the world's major banking countries, although the Community version does permit inclusion in the capital base of a bank's fund for general banking risks without limit. These provisions are set up to cover, for example, individual defaults by major clients or the decision of a major client to pull out all his or her funds overnight.

This directive will provide the basis for the solvency ratio proposal, which should be adopted during 1989. In keeping with the Basel Committee recommendations, the Commission has proposed to set ratios throughout the EC at 8 per cent. This represents the relationship between own funds of a credit institution (the numerator) and its total assets and off-balance sheet liabilities as adjusted to reflect differing degrees of risk (the denominator). The solvency ratio directive provides for common definitions and risk weightings for the components of the denominator, establishes that the numerator will be own funds as defined by the Community directive, and lays down rules for calculation of the ratio.

Currently, obligatory solvency ratios based on a risk-asset system exist only in Belgium, France, Germany, Italy and Spain, while Ireland, the Netherlands and the U.K. have nonstatutory ratios. Denmark, which operates a less sophisticated solvency ratio system, is on the verge of introducing a risk-based system, but Luxembourg, Portugal and Greece do not impose any system at all to assess bank risks.

According to the 1985 Internal Market White Paper, the second banking directive should be adopted by the Council during 1989, but 1990 may be more realistic. As noted already, this directive would introduce a single banking licence valid throughout the 12 Member States via the principle of mutual recognition: once a bank fulfilling the various requirements outlined in the directive received establishment authorization in one Member State, this would be automatically recognized by other EC countries.

Universal banking: The single licence would be valid for an agreed list of activities listed in an annex to the draft directive. These include not only commercial banking operations (deposit taking and lending, money transmission, foreign exchange) but also investment banking activities (securities trading, underwriting, fund management). The proposal also would permit banks to hold equity in non-banks, subject to certain limits (individual holdings not to exceed 10 per cent of the non-bank's capital, and in aggregate not over 50 per cent).

Under the principle of home country control, a bank's licence would be limited to those activities allowed by its home regulator. But the deregulatory thrust will clearly be toward a "universal bank" on the German or Swiss model. For mutual recognition and home country, control will increase competition not only among banks across the EC but also among the different national regulatory systems: countries that try to maintain tight limits on the activities of their own banks would be putting them at a competitive disadvantage vis-à-vis their European rivals.

The reciprocity issue: The single licence would in principle benefit all banking institutions, whether European or foreign-based (the latter would have to be established within the EC through a local subsidiary, not just a branch). Since the proposal was unveiled in early 1988, however, a great deal of confusion and concern has arisen over the question of reciprocal access conditions for foreign banks. The Commission's text recognizes the eligibility of foreign banks for this single licence provided reciprocal access is granted in their home country to banks from each of the 12 EC Member States.

In November 1988 the Council of Ministers instructed the Commission to redraft the text to clarify this provision. The ministers want it to be clear that foreign-based banks already established within the EC before the directive comes into force will be entitled to the single licence under the GATT principle of national treatment (see B.2).

Regarding new banks, the Member States agree that reciprocity should be used primarily as a "bargaining chip" in the Uruguay Round to force third countries to open their markets. But national governments (including Germany, the Netherlands and Luxembourg, but particularly the U.K., whose financial services legislation contains its own reciprocity provisions) are reluctant to give Brussels the authority, which it does not currently have, to determine whether reciprocity exists or not. As a result ministers have asked for a redrafting into more "GATT-friendly" terms.

Although discussions on reciprocity will continue for some time, the impact is unknown yet -- certainly for U.S., Swiss or Canadian banks. Once again the real target is access to the Japanese market -- but even here, one national expert believes that when the directive is finally adopted "there will be some type of review regarding reciprocity," but that is all.

<u>Investment services</u>

The Commission's proposal for a single licence in the investment services area follows very closely the second banking directive. This proposal covers all non-banking firms involved in stockbroking, portfolio management, securities dealing or market making, options and futures as well as investment advice. It seeks to harmonize national regulations on the registration of such firms, including their admission to stock exchanges, and also to introduce minimum standards regarding their competence and conduct of business.

The proposal will introduce a general obligation for a firm to respect the capital adequacy requirements in the Member States in which it operates. The Commission will propose a harmonized "own funds" directive at a later date.

Other requirements include the obligation that investment services firms would have to disclose share ownership in their capital, particularly when majority ownership passes from one shareholder to another. A similar requirement exists in the second banking directive.

Regarding reciprocity in investment services, EC officials admit that the current provisions "are as obscure as in the banking directive." As a result they stress that any developments or changes in the banking reciprocity provisions will be automatically taken up for investment services.

<u>Insurance</u>

Over the past year the Community has made progress in the insurance sector. In June 1988 the Council adopted a key framework directive in the "non-life" field, and the Commission in December tabled the first implementing directive, covering motor vehicle insurance. In a separate development it has also proposed a directive on freedom to supply services in the life insurance sector.

In the non-life field, the Commission has been careful to make a clear distinction between insurance for large corporate customers and that for individuals. In the case of "large risks," where the client is a major company insuring for example its fleet of cars, it is assumed that clients of this size do not require common standards of consumer protection -- they are basically big enough to take care of themselves, and therefore should be totally free to seek insurance policies wherever they see fit in order to benefit from the best price. In this case the rules governing an insurance contract will be those in the insurer's home country. As a result companies will be able to deal with one insurance firm for all their European operations.

On the other hand, the Commission (following a key 1986 ruling by the Court of Justice) considers that individuals do require added protection. As a result, where it is the insurance company which seeks to service such customers it has the right to establish itself in other Member States, but it must respect the rules in force in the host country.

In both cases the tax regime will be that in the country where the policyholder resides.

Life insurers would be free to sell policies to residents of Member States where they are not established, on the buyer's own initiative; but they could not actively solicit such cross-border sales, for example through advertising. This draft directive does not cover life insurance policies associated with group pension schemes, which will be the subject of a follow-up proposal during 1989.

At a much later date the Commission will come forward with rules to harmonize the national regulatory systems themselves, which will then open the way to mutual recognition of insurance authorizations along the "home country control" lines of the second banking directive.

Shareholder protection

Behind these sectoral activities, the Community is working on a series of financial market regulatory proposals that will affect all sectors of business. The prime objective is to assure adequate and equitable protection for shareholders throughout the EC, which is viewed as a mandatory foundation for the freedom of capital flows. In all cases the chosen technique relies on increased transparency and information to shareholders.

- Disclosure: In December 1988, the Council adopted an "anti-raider directive," setting out a series of thresholds regarding the transfer of major shareholdings in a listed company that would trigger a public disclosure requirement. When a purchase (or sale) causes a shareholding to go above (or below) 10, 20, 33, 50 or 66 per cent of the voting rights, the company and the competent national authorities must be notified within seven days. Nominee shareholdings will be consolidated for this purpose.

- Prospectuses: Also in December, the Council agreed on a common position on rules governing the publication of detailed prospectuses prior to most new issues of shares or bonds in the Community (excluding Eurosecurities, which are normally placed at short notice with institutional investors).

- Insider trading: The Council has begun examining the Commission's proposal outlawing insider trading. Currently only France, Denmark and the U.K. legally ban insider trading. In Germany most firms respect a code of conduct, and in Belgium, Ireland and the Netherlands legislation is under consideration. This directive would simply ban the following activities in general terms, leaving the details of enforcement to the Member States: the use of privileged information for one's own profit; passing on such information to a third person; or recommending to a third person the purchase or sale of certain shares as a result of such information.

- Takeovers: The Commission has just proposed a directive harmonizing national rules relating to takeovers (for details see B.2). The aim is to protect shareholders while permitting the necessary restructuring of European industry.

Business use of the ECU

While the establishment of a European central bank and a common EC currency do not form part of the white paper agenda for 1992, many businesspersons as well as government leaders are convinced that the Single Market process -- and especially the planned removal of exchange controls -- will lead inevitably in this direction. The Delors Committee is due to report by June on possible measures; although the committee is apparently divided on how far and fast to proceed, its recommendations are likely at a minimum to include further moves to strengthen the EMS and tighten co-ordination of national monetary policies.

Some also see growing private use of the European Currency Unit (ECU) as a possible transitional mechanism to a true common currency. Introduced in its present form in 1979, the ECU is merely an accounting unit, equivalent to a weighted basket of EC national currencies. But it has gained growing acceptance among borrowers and investors, acounting as of 1988 for 2.5 per cent of banks' outstanding international lending and 4 per cent of the stock of international bonds. ECU lending is primarily between banks, with a modest volume of syndicated loans to (mainly Italian and French) non-banks. London is the principal centre for ECU bond issues and Paris for ECU banking business. In 1988 the U.K. began issuing ECU-denominated treasury bills, and France is expected to follow shortly. An interbank clearing system for ECUs is co-ordinated by the Bank for International Settlements.

In 1987 some 100 major European firms, led by Philips, Fiat and Total-CFP, formed an Association for the Monetary Union of Europe (AMUE) with the aim of pressuring governments to strengthen the EMS and move toward ever greater monetary integration. The ultimate goal is to create a European central bank. AMUE intends to accomplish this goal through a three-pronged strategy -- exerting direct pressure on governments and institutions, expanding the Community constituency for the ECU, and increasing the use of the ECU within the European and international business community.

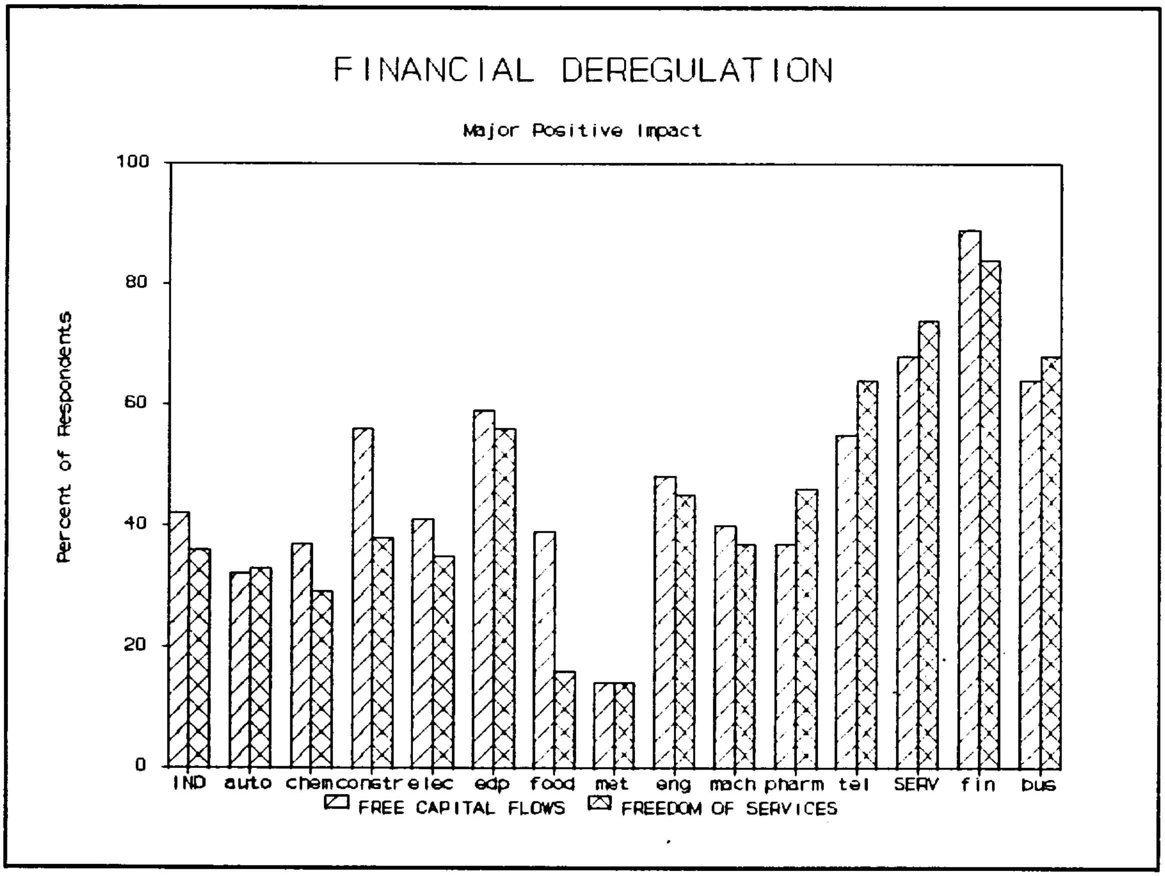
The thinking behind AMUE is that, as more companies adopt the ECU as a transaction and a financing currency, both the demand for the basket currency and the supply will grow. The burgeoning supply of unregulated ECUs will cause monetary authorities serious discomfort, and eventually provoke them to action to regulate the unit, providing the institutional structure the ECU needs to become a full-fledged Eurocurrency.

As a basis for future action, AMUE carried out a survey in 1988 of over 1 000 executives to determine attitudes and use of the ECU. The survey showed a much more positive attitude in the weak-currency countries such as France and Italy, where support reached 98 per cent, while in Germany only 60 per cent supported its use. Nevertheless, almost 30 per cent of the sample plan to use the ECU as an invoicing currency in the future and approximately 25 per cent in long- and short-term financing. A smaller percentage (19 per cent) are contemplating use of the ECU in international investments, and 17 per cent plan to follow the lead of France's Saint-Gobain and Total in adopting the ECU as an accounting currency.

Industry perspectives

The free movement of capital and liberalization of financial services, while welcome to industrialists, will obviously have the greatest impact on the financial services sector itself (Chart B12.1). Close to 90 per cent of the banks, securities houses and insurance companies in the business impact survey saw these as the major benefits of the Single Market program for their own businesses, and only a handful expressed mild reservations over the prospect of unfettered competition in their sector.

CHART B12.1



Says José Ramon Alvarez Rendueles, president of Banco Zaragozano and chairman of Cofir (the De Benedetti holding company in Spain): "The effects of 1992 in the financial area will be revolutionary. We will be able to place our capital where we expect the best yield." Drawing on his experience as a former central banker, he points to the broader implications of financial deregulation:

"First, free capital movement will optimize the application of savings. The cost of capital will tend to equalize, leveling interest rates and narrowing the margin between borrowers' costs and the benefit to savers.

"Second, the liberalization of banking is now accelerating throughout Europe -- not just in the EC. The European model will be a universal bank, including property and security investments. Spanish banking legislation is not so far from the proposed European model; the reforms of recent years are moving forward toward a free banking market.

"Finally, governments will face increased pressure for major advances in monetary integration, for convergence of monetary policies. A European central bank and common currency seem premature now; we will see what the Delors Committee proposes to the summit next June. Ultimately this is a political problem. But as Jacques Rueff once said, 'Europe will be done through its currencies or not at all.' Without monetary integration we cannot talk about a true common market. If the U.K. fails to join the eventual EC monetary integration institutions, with a common currency, we won't have a real Single Market. It may take 20 years, I don't know."

In the shorter term, industrialists interviewed for this study are focusing their hopes on three main themes: greater freedom in managing their funds, improvements in banking services as a result of increased competition, and the possible utility of the ECU.

Says the chief economist of a major French multinational:

"When one reflects on all this talk of Europe, the great affair I believe will be the liberalization of capital movements. If one really makes a 'Europe of capital' in 1990, the rest will follow necessarily, because that means one can place his capital in the country that is most interesting, so that one can play on the differences of taxation, on advantages of incentives, etc. At that point everyone will invest in the most advantageous countries and not in those that are overtaxed. So, one will be obliged to harmonize taxes. Thus, my answer to whether Europe will be made or not, is I think the prerequisite is to make a Europe of capital. The rest will follow."

A French hypermarket firm has similar ideas:

"Free movement of capital will be a major positive impact. We will be able to go where taxes are lowest and the tax inspectors least effective. We could consider setting up a holding company in Holland, for example. There's no doubt that it will lead to a general easing of administrative controls.

"Banking liberalization will also have a positive effect on our bank relations. It will wake up French banks, to the benefit of French groups."

A U.S. forest products company prefers dealing with American banks:

"Usually European banks are not as flexible. We work with American banks because they know how we operate, how we like things to be done. If you have a problem it can usually be settled by a telephone call; there is good will on both sides, we don't try to blame each other. European banks don't really try to be flexible -- they stick to their paperwork, their this, their that. The worst are France, Belgium and Italy. The U.K. is not bad, but I think they still have a lot to improve."

As to the ECU, a U.S. lighting manufacturer says:

"We will be denominating transactions in ECU. We already have some customers, mainly those OEM fixtures manufacturers that buy our lamps, who have requested this. They would like to be invoiced in ECUs. So the demand is coming from the market, and it could be a good marketing tool from us."

A French multinational with some experience of ECU transactions is cautious about their potential:

"Our product division fixes internal transfer prices and invoices shipments between the national subsidiaries in ECU. This divides the risk between the different countries. The private ECU is a currency that is developing spontaneously -- without institutions, without a central bank. Of course that creates problems when you want to create a financial market with real possibilities -- for the moment it remains rather marginal. You can now use ECU in Germany too, but you have to make a market."

For the banks, financial deregulation poses a new set of competitive challenges and possible strategic responses.

An American venture capitalist in Italy is skeptical about the impact of EC liberalization efforts.

"People keep talking of a revolution in the making, which is exaggerated. What we'll see is more of an evolution. Although everybody is jumping on the 1992 bandwagon, when push comes to shove countries still react in strong nationalistic terms. This is particularly true when you start talking about a country's finances. The Italian government in particular will not easily relinquish its hold on the Italian banks, which traditionally serve up a major chunk of the government's financial resources.

"If European financial markets do open up, this would of course have a tremendous impact on the way Europe does business. Right now the amount of effort required to achieve the same results in Europe as you would for example in the U.S. is much higher. Looking at things from a strict Italian point of view, costs are substantially higher, plus you have to make do with a third-class infrastructure."

An Italian investment banker is more sanguine about the effects of freer competition:

"I believe an opening up of the banking sector will translate into lower borrowing costs for clients. Once the market becomes more competitive, the Italian banks will have to start being more receptive and responsive to customer needs. Nowadays most banks have a 'take it or leave it' mentality because they are the only game in town.

Like many other bankers in Italy, he sees advantages in linkups with foreign banks:

"In order to be successful in the big security markets, you have to show your muscle. Placing power alone won't do it; for the juicier project financings or M&A deals, you have to be able to put your money where your mouth is. Aside from increasing a bank's financial muscle, teaming up with a foreign bank also supplies valuable expertise. Italian investment banks are still weak in portfolio management, which requires among other things in-depth knowledge of foreign security and equity markets. I feel rather confident of our M&A expertise, but I start getting nervous when I think of Manny Hanny moving in across the street and offering portfolio management services."

A German banker foresees relatively limited scope for cross-border expansion, except through M&A and alliances between banks:

"There will not be much change for the commercial banks because all major banks are already in all EC markets. It won't be profitable for small banks to be everywhere in the EC, so they will concentrate on new offices in places like Frankfurt -- if they are not there already. There is no reason for banks to open retail branches everywhere. Banks now have foreign offices in the EC mainly for business customers, and there will be more such offices in the future. As for investment banks, 1992 will mean more competition, but it will be enough for them to have only representative offices in other countries."

A Danish commercial banker sees three types of reaction:

"One, a bank can concentrate on servicing a region in Europe; most Danish banks will stick to a part of Denmark. Two, a bank can try to cover Europe in full by buying competitors or putting up its own affiliates in each EC country; that is the strategy I believe Deutsche Bank is following. Or three, banks can engage in 'strategic alliances.' This is what our bank will do. We are already participating in one such alliance, with partners in Sweden, Finland and Norway."

Amro Bank, the third largest in Holland, has chosen the merger route. Its linkup with Belgium's Générale de Banque, announced in 1988, will create the sixth largest bank in Europe. Says Amro's treasurer A.J. Meys:

> "I believe that the consolidation of banks of comparable size and market share will snowball in the coming years. But the mergers and acquisitions will not be concentrated in Europe, as banks are keeping an eye on takeover possibilities in the U.S. -- especially as nation-wide banking there is becoming a reality."

In the view of Rainer Gut, chairman of Crédit Suisse, the trend toward universal banking in the EC will favour the big Swiss banks that have always followed this model:

> "The EC program will set the pace for world-wide progress towards full-service banking. It is not inconceivable that, even after 1992, EC Member States might have regulations limiting the range of banking activities open to their financial institutions. Even so, those same countries will be obliged to grant banks from countries with full-service banking systems permission to carry out the whole range of their activities. The same applies to non-EC banks which receive an EC-wide licence as a result of a reciprocity deal. Sooner or later, the effect of this and the resultant competition will probably be to break down the distinction between specialist banks and full-service banks.
>
> "This is another area in which the big continental European banks, including the Swiss, seem to have an advantage over their American rivals. They have dozens of years of experience with full-service banking systems, whereas the Glass-Steagall Act still divides commercial banks from investment banks in the U.S."

In the insurance sector, two big Swiss companies interviewed as part of this study are similarly confident. They are well represented in the EC and in recent years have gone on an acquisition binge to strengthen their position. Through their subsidiaries in the EC they can take full advantage of a freer market, and their international experience has taught them the art of cross-border business. By comparison, the large French and German companies have been more nationally oriented, while the southern European countries do not have well-developed insurance services.

A Swedish executive, who works at a U.S. insurance group which over the past 40 years has built up a pan-European network of local subsidiaries, outlined four possible reactions to the emerging Single Market:

> "Some people say it means only the big players will remain. I don't think that's true; it depends what philosophy the others adopt. Either you are like us and a few of our competitors, the Zurich or Winterthur for example, who are well spread across the EC. Or then you have the really big national companies like UAP, the biggest here in France but not really well spread worldwide or even in Europe, and some of the big English companies. They want a presence here, which they can get by acquisitions; establishing from scratch takes too long. We see a lot of cross-border activity going on now.
>
> "Then there may be another philosophy, which isn't too bad perhaps. Hafnia, the second-largest Danish company, is saying: 'We want to create some kind of network, if we can put together six or seven companies of our own size we'd be present. We don't have the resources for buying companies in each country, we don't really know the markets. But we can work together, perhaps with a minor shareholding in each other -- 5 per cent or something symbolic like that. Then joint product development, sharing market knowledge, etc. can follow.'
>
> "That's an interesting idea. The problem is, they are number two in Denmark, but the same size of company as they are in Germany is number 28, not a major player. And also we know that any type of voluntary co-operation has its limitations -- you can't give orders, force people to do things ... you have to write each other letters, negotiate, etc.
>
> "Then there is a third idea -- co-operation with a major player like ourselves or the Zurich. You form a kind of strategic alliance. This could enable a smaller company to defend itself in international competition.

"The fourth one is that some companies, even if small, can specialize in one niche, like bad debt or export credit insurance.... And some may be able to survive in a regional niche; even if they lose some business, they may have some kind of local monopoly on, say, building insurance.

"What I'm afraid of is that some companies, especially Scandinavian ones, are rushing into Europe, thinking they can acquire a small company in Germany (because that's all they can afford) and write insurance across the EC. So they will run in and will lose their shirts — just as they did in the mid-'70s when they rushed into the U.S. because they said their home markets were too small, they needed to go to the market where 50 per cent of the world insurance premiums were, and they lost millions or billions. Now the same companies, 10 years have passed, and their boys have forgotten. Now the new thing is Europe, and they'll be rushing in and losing their shirts here in the competitive climate I've been talking about."

APPENDICES

APPENDIX I

INTERNAL MARKET LEGISLATION

Halfway through the eight-year 1992 initiative, only 40 per cent of the EC's 1985 White Paper on Completing the Internal Market proposals have been adopted. What is more, some of the toughest arguments are yet to be fought — especially in the indirect taxation area. Nevertheless, completion of even 40 per cent of the legislative program is impressive, given the scope of the White Paper's aims.

Not all the 285 directives listed in the White Paper (and others brought forward since) will have a broad impact on trade and investment. Many are narrowly focused on specific subjects or products — e.g., directives on air crew qualifications, oligo-elements in fertilizers, or eradication of contagious bovine pleuro-pneumonia in Portugal.

This appendix provides summary details and progress reports on about 62 of the Community's key directives, including some which have already been adopted and some which have not yet left the Commission's drafting table.

The Legislative Process

Tracking the development of Internal Market (IM) legislation requires a basic understanding of the EC's decision-making process, particularly since its reform in 1987 via the Single European Act. The SEA introduced a complex new co-operation procedure which, by increasing the "democratic" input into EC legislation, also adds a good nine months to the already snail's pace EC legislative process. The process involves two readings by the European Parliament, adoption of a Common Position (CP) by the Council of Ministers between the two, and final adoption after the second reading.

However, at the end of the day, almost two thirds of the proposed IM legislation can now be adopted by "qualified majority."* When the IM program was launched in 1985, this was true for only about a third of the proposals. Unanimous voting in the Council is still required for proposals relating to taxation, free movement of persons and employment law (although health and safety standards as well as mutual recognition of qualifications are both decided by qualified majority). Free movement of persons generally refers to questions of security — terrorism, drug smuggling, etc.

Timely and constructive lobbying thus becomes more important than ever. By timely, Brussels observers mean that effective lobbying should take place during the drafting stage — and certainly prior to the first reading of the Parliament. Thereafter, amendments are much harder to introduce.

Despite the European Parliament's increased role, there is nothing in the SEA that forces the Council of Ministers to accept Parliamentary amendments to legislation. However, if the EP amendments are accepted by the Commission, the Council must vote unanimously to adopt an unamended text. If the Commission refuses to take on the EP's amendments and the Council in its Common Position refuses to as well, the EP can try again during its second reading. But amendments introduced on the second reading must be adopted by an absolute majority of all Parliamentarians (i.e., 259 votes) and not just those present. This vote would mean that in order to approve the unamended text the Council would have to adopt its final approval by unanimity. If the Council accedes to the EP's wishes, a qualified majority suffices.

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*In this procedure the vote is weighted as follows: France, Germany, Italy and the U.K. have ten votes each; Spain eight; Belgium, the Netherlands, Greece and Portugal five each; Denmark and Ireland three each; and Luxembourg two. Of the total 76 votes, 54 are required for a qualified majority.

PHYSICAL (ADMINISTRATIVE) BARRIERS TO TRADE

1. Single Administrative Document (SAD)

Status: adopted 1985
Implementation: Jan. 1, 1988

This directive introduced a single multi-copy document to be handed over to customs officials at intra-Community crossings. While it did replace up to 60 different national documents, the SAD is not viewed as a simplification, but rather as a necessary first step in the harmonization field. It thus paves the way for electronic customs procedures. It has also been adopted for use with the EFTA countries.

2. Elimination of bilateral transport quotas

Status: adopted June 1988
Imp: 1988-93

Currently 80 per cent of all cross-border trucking within the EC requires individual one-trip national licences authorizing the truck to go from one specified location to another. The numbers of licences are negotiated and granted on a bilateral member-state to member-state basis. Only 20 per cent of trucking benefits from Community licences that are valid for multiple trips throughout the EC. The complexity of the system is by all accounts byzantine. The directive adopted in June 1988 will gradually phase out the individual one-trip national licences to the benefit of Community authorization. During 1989 Community licences will equal 40 per cent of current needs and by 1990, 60 per cent.

TECHNICAL BARRIERS TO TRADE

The New Approach to Product Harmonization

The "new approach" means that at the Community level the EC will harmonize only those elements that are deemed essential to the health and safety of consumers. These essential requirements are then given to CEN-CENELEC who, in turn, prepare standards, which, if met, confirm that these essential requirements have been met. A company has two choices: it can meet the European standard as prepared by CEN-CENELEC and thus be deemed to meet the essential requirements, or it can seek third-party certification. It will be left to each Member State to develop the manufacturing specifics required to respect the European norm. However, once a product respects one national set of specifics, it is guaranteed free circulation throughout the Member States. In this way the Commission believes market forces will be allowed to play, determining the best manufacturing standard.

3. Pressure vessels

Status: adopted June 1987
Imp: July 1, 1990

This was the first directive adopted under the Community's new approach to product harmonization.

4. Toy safety

Status: adopted May 1988
Imp: Jan. 1, 1990

The directive sets out common safety requirements for all toys, covering chemical characteristics, requirements for inflammability, etc. It replaces two previous attempts to legislate European-wide toy standards. This directive represents the first and only time so far that the new approach has been applied to consumer products.

5. Machine safety

Status: Council CP December 1988
Imp: Jan. 1, 1992 (transposed into national law)
Jan. 1, 1993 (machines must comply)

This proposal establishes major safety standards for all types of industrial machinery ranging from printing presses to cutting equipment.

6. Preventing radio interference (electro-magnetic compatibility)

Status: Council CP October 1988
Imp: (1992)

This directive will affect all electrical appliances, telecommunications, medical and scientific equipment and fluorescent lamps. It calls on manufacturers to produce these products in such a way as to limit their ability to generate electromagnetic interference and to build them with an adequate resistance to electromagnetic interferences.

The directive calls for the introduction of a European standard in this area no later than the end of 1992, but in the meantime it sets up a Community procedure to determine whether existing national norms respect the objectives described above. Where a committee of national experts determines that a national standard respects the objectives, products certified as complying with the national standard will be guaranteed free circulation throughout the EC.

7. Pharmaceuticals pricing transparency

Status: adopted December 1988
Imp: Jan. 1, 1991

This directive starts the move toward more objective and transparent procedures for the granting of marketing authorizations and the admission of pharmaceuticals to social security reimbursement schemes. The directive introduces a maximum 90-day period in which administrations must decide on initial pricing and reimbursement requests -- although a 90-day extension is permitted when an application provides inadequate supporting evidence.

8. Biotechnology and hi-tech goods

Status: adopted December 1986
Imp: July 1, 1987

This proposal falls within the EC's efforts to lay the foundation today for a common market in products which do not yet exist. It created a co-ordination procedure at EC level to examine marketing applications for biotech and hi-tech products: the procedure is obligatory for biotech inventions, which the EC views as a priority sector, and optional at the request of the firm for hi-tech products which will be defined case by case.

The procedure means that as soon as a company has filed a marketing authorization request with one national administration, the file is transmitted immediately to the Commission which then relays it to every other Member State. While the national authorization procedure continues normally, an EC committee of national experts examines the product application and issues a nonbinding opinion.
Commission experts hope the opinion will be taken into account in all Member States.

ENVIRONMENTAL PROTECTION

9. Environmental impact assessment

Status: adopted 1985
Imp: July 1, 1988

This directive requires all major public and private investments to carry out environmental impact assessment reports prior to the construction of a factory, power plant, highway, airport, etc. It is intended to ensure that potentially harmful aspects of a development are removed at the design stage. Implementation according to EC officials is behind schedule, but the Commission generally gives Member States an extra 12 months before it starts filing complaints.

10. Large combustion plants

Status: adopted June 1988
Imp: 1993-2003

This directive will lead to major reductions -- compared to 1980 pollution levels -- in both sulphur dioxide (SO_2) and nitrogen oxide (NO) emissions by large combustion plants -- primarily power plants and refineries. The directive affects both old plants and new, introducing particularly stiff rules for plants commissioned after July 1988.

The SO_2 reductions will be introduced in three phases: 25 per cent cuts in 1993, 43 per cent in 1998 and 60 per cent cuts by 2003. New plants however will be required to introduce emission levels that are 80 per cent below 1980 levels. NO reductions will be cut by 36 per cent in two stages: half in 1993 and the remaining half in 1998.

This proposal is particularly important due to the high cost of implementing the required pollution control measures. The cost was the main reason that Member States took five years to adopt this directive.

11. Small car emissions

Status: Council CP November 1988
Imp: 1992-93

The Commission's proposal to reduce exhaust emissions for small cars (with engines smaller than 1 400 cc) is the last in the package of European exhaust emission levels, most of which were adopted by the Council in December 1987. The Commission's small car proposal calls for a 58 per cent reduction in nitrogen oxide and unburned hydrocarbon emissions and a 48 per cent decrease in carbon monoxide emissions. These limits would apply to any new model of car sold after October 1, 1992, and to any new vehicle sold after October 1, 1993.

The Commission is now expected to table proposals covering uniform speed limits and another establishing a common test cycle for pollution control throughout the 12 Member States.

12. Biotechnology emissions into the environment

Status: awaiting EP first reading
Imp: ?

These proposals are viewed as a necessary element to providing the legal security required by industry to develop the biotechnology sector in Europe. The first proposal covers the contained use of genetically modified micro-organisms, which would apply to the use of biotechnology in the laboratory or as part of a manufacturing process. The second proposal covers the deliberate release of genetically modified organisms into the environment, which relates to both experimental releases or the marketing throughout the EC of new products containing genetically modified organisms.

The directives differentiate between small-scale processes involving micro-organisms and large-scale manufacturing processes. They also draw a distinction between micro-organisms which are considered generally safe and those with a recognized degree of risk. The Commission hopes to introduce a series of notification requirements including the filing of a safety assessment report on the planned project. Additional details would be required if potentially dangerous organisms were involved.

13. Civil liability for damages

Status: awaiting Commission proposal

This proposal will introduce the principle of strict liability on the producer of waste. In other words, where there is damage to the environment, whether or not there is negligence on the part of the waste producer, the waste producer pays. It will cover all wastes and not just toxic waste.

PUBLIC PROCUREMENT

Since the early 1970s the Commission has been trying to force open national purchasing practices to competition from at least the other Member States. The two initial directives covering public works and supply contracts date from 1971 and 1977 respectively and excluded four sectors: water, energy, transport and telecommunications. The original proposals underwent important revisions in 1988 aimed at reinforcing the transparency of tendering procedures and limiting the use of emergency or single tenders. The provisions include obligatory publication of tender notices in the EC's official journal and publication of the winning tender.

In the run-up to 1992 and beyond the Commission hopes to extend the liberalization move to the excluded sectors and to introduce a so-called standstill or suspension authority.

14. Standstill powers

Status: EP first reading May 1988; proposal amended December 1988
Imp: ?

As originally drafted, this directive would have enabled the Commission to stop a government from awarding a tender, if a company complains that EC procedures and publication requirements have not been respected. But the amended version greatly restricts the Commission's capacity to intervene, even if the procedure has not followed the rules. As amended, however, it does have a much better chance of Council adoption.

15. Liberalization of transport, energy and water sectors
Status: awaiting EP first reading
Imp: (1992)

These proposals would start the process toward opening government tenders to Community-wide competition for both supplies and works in these three areas. The Commission has proposed a much more flexible approach to deregulation than in existing legislation. This means in practice that concerned purchasers such as airports, railway companies and electricity suppliers will have several options for placing tenders. These range from maintaining a pool of qualified suppliers (provided the conditions for entering are objective) to calling for separate bids for each contract.

16. Liberalization of telecommunications sector

Status: awaiting EP first reading
Imp: (1992)

This proposal calls for a progressive opening of telecom equipment supply and works contracts: 70 per cent during the first year leading up to total liberalization by 1992 if all goes on schedule.

FREE MOVEMENT OF CAPITAL

17. Liberalization of capital movements

Status: adopted June 1988
Imp: 1990-92

This directive removes the remaining barriers to free circulation of capital by phasing out restrictions on short-term capital movements such as investments in short-term securities, financial loans and credits, including banks' ability to lend domestic currency to non-residents and the opening of foreign bank accounts.

Exchange controls have already been abolished in Germany and the U.K., while Denmark's liberalization exceeds the requirements of the directive. France, Italy, Belgium/Luxembourg and the Netherlands must comply by mid-1990; Ireland, Spain, Greece and Portugal by the end of 1992 (the last two may delay until 1995 in certain circumstances). A safeguard clause allows controls to be reimposed where "exceptional" short-term capital movements would seriously disrupt monetary and exchange rate policies.

Capital movements associated with commercial transactions, acquisition of shares and bonds and long-term investments were liberalized under earlier directives (1960 to 1986).

FINANCIAL SERVICES

A) BANKING

18. Second Banking Directive

Status: awaiting EP first reading
Imp: ?

This directive is the key proposal in the EC's drive to introduce a common market for banking services, but is totally dependent on the prior or simultaneous adoption of a series of proposals aimed at harmonizing basic banking rules regarding, for example, solvency ratios, own funds or deposit guarantees.

The directive will introduce a single banking licence valid throughout the 12 Member States. Once a bank is authorized by its home country, it will be free to sell its services throughout the EC, but will have to comply with host-country rules on investor protection, etc. Controversial issues include controls on banks' shareholdings in non-financial businesses and application of a reciprocity principle with regard to banks from non-EC countries.

The success of this proposal is particularly important because it sets a precedent for similar licences in other service areas, notably investment services. The outcome regarding its reciprocity provisions is equally crucial as a precedent in other sectors.

19. Solvency ratios

Status: awaiting EP first reading
Imp: (Jan. 1, 1990)

This proposal would require banks and credit institutions to limit their lending and financial exposure to a specific percentage or rather a fixed multiple of their own funds. Provisionally, the Commission suggests setting this so-called solvency ratio at 8 per cent. Details will be compatible with capital adequacy standards set by the Basel agreement for G-10 countries.

20. Own funds

Status: Council CP December 1988
Imp: Jan. 1, 1993 (1994 for Belgium)

This directive will harmonize national rules defining what goes into a bank's own funds (the numerator for solvency ratios) to include not only shareholder funds and retained profits but also such items as loan-loss reserves.

B) INSURANCE

21. Non-life insurance

Status: adopted June 1988
Imp: June 30, 1990

This proposal represents a major step toward a common market in the area of insurance. It is of particular importance to companies because it opens the possibility of one insurance dealer serving the entire EC and as a result giving the best coverage at the best price possible. It covers large risks for non-life insurance contracts. This proposal means that any Community insurer will be able to underwrite contracts to cover risks situated all over the Community without the necessity of opening subsidiaries, agencies or branches in every country. It also gives to the insurance buyer access to companies established anywhere in the EC.

22. Life insurance

Status: Commission proposal December 1988
Imp: ?

This proposal represents the first step toward freedom to supply services in the life insurance sector. It does not cover policies associated with pension schemes, but only individual policies.

C) SECURITY MARKETS

23. Disclosure of major shareholdings

Status: adopted December 1988
Imp: 1991

This directive represents the first step toward European anti-raider legislation, and seeks above all to protect the small individual shareholder from raiding abuses by increasing the transparency of large shareholdings. It must also be viewed as a necessary element in a single capital market.

The proposal sets out a series of thresholds regarding the purchase or sale of major shares in the voting rights of a company which would trigger a public reporting requirement. When either an individual or a legal entity purchases or sells 10, 20, 33, 50 or 66 per cent of the voting rights, the company and the competent national authorities must be notified within seven days. Moreover at the time of implementation all individuals or legal entities which own more than 10 per cent of the voting rights must inform the company's general assembly meeting and the competent national authorities.

24. Takeovers

Status: Commission proposal December 1988
Imp: ?

This proposal is viewed as part of the Commission's strategy to introduce "equitable protection for shareholders throughout the common market." The text requires any shareholder with one third of the voting shares in a firm to launch a bid for the other two thirds. Partial takeover bids would be illegal. An offer document must be published at the time the official bid is launched, spelling out the bidder's intentions regarding the target company's activities, employment, etc.

25. Insider trading

Status: EP first reading June 1988
Imp: ?

Banning insider trading activities throughout the Community is viewed by the Commission as a necessary element for creating the Single Market in securities. Currently only France, Denmark and the U.K. legally ban insider trading. In Germany most firms respect a code of conduct, and in Belgium, Ireland and the Netherlands legislation is under consideration.

The directive has been described by EC experts as "very basic and easy to implement" because it would simply ban the following activities without providing numerous detail: use of privileged information for one's own profit; passsing on information to a third person; or recommending to a third person the purchase or sale of certain shares.

26. Investment services/advisors

Status: Commission proposal December 1988
Imp: ?

This proposal would introduce a single licence for investment services valid throughout the 12 Member States via the principle of mutual recognition. The legislation will also seek both to harmonize national regulations concerning the establishment of such firms and to introduce minimum standards regarding their competence and conduct of business.

27. Broadcasting activities

Status: EP first reading January 1988
Imp: ?

The key to this proposal is the principle that once an emission respects the rules and regulations of one Member State, it must be allowed transmission everywhere in the EC. It would eliminate the current system of double controls by placing unique responsibility for compliance on the transmitting country.

The directive seeks on the one hand to increase the European content of television programming and on the other to introduce common advertising rules. This second objective includes a ban on tobacco advertising and restriction on alcohol advertising, limiting the total advertising time to a maximum 15 per cent of global broadcasting time. If these principles are respected the receiving country cannot prohibit the emission.

28. MAC standards for satellite TV

Status: adopted 1986
Imp: immediate

This proposal introduced common standards for satellite television broadcasts, either direct or via cable. In this way the Community should avoid the current market divisions between PAL and SECAM standards for terrestrial broadcasting.

The directive is valid through the end of 1991; by then the Commission is to have tabled proposals for High Definition TV, which are viewed as a later stage in the evolution of the Multiplex Access Component (MAC) packet of standards.

29. Mobile telephones

Status: adopted June 1987
Imp: Dec. 26, 1988

This directive will introduce common standards for the next generation of mobile telephones in order to put an end to the existing chaos provoked by the numerous standards currently operating throughout Europe.

30. Mutual recognition of type approvals (first stage)

Status: adopted 1986
Imp: July 1, 1987

This directive introduced the first stage of mutual recognition for the marketing of telecommunications terminal equipment throughout the EC. It provides for mutual recognition of testing results, meaning that companies wishing to sell equipment in all 12 Member States do not have to carry out 12 sets of tests.

31. Full recognition

Status: awaiting Commission proposal during 1989
Imp: ?

This will take the previous directive one step further to the mutual recognition of marketing authorizations, meaning that once equipment has received one national authorization, it is valid throughout the 12 Member States. Adoption of this proposal by the Council will depend undoubtedly on parallel adoption of common standards for terminal equipment.

32. Open network provisions

Status: Commission proposal December 1988
Imp: ?

This directive lays down the conditions or establishes the rules of the game by which individuals or corporations can use telecom networks operated by the PTTs for their own purposes. It is therefore closely linked with the Article 90 directive described below on telecom services.

The rules of the game according to the Commission must respect four basic principles: conditions for access must be transparent, objective, nondiscriminatory and they must be published. However, Member States may require that the concerned services guarantee the safety and integrity of the network as well as a certain degree of "interoperability." By this criterion the Commission refers to the possibility that when European telecom standards exist they will be obligatory.

Article 90 directives

Article 90 of the Rome Treaty allows the Commission to issue directives on its own authority — without either Parliamentary debate or Council approval — to ensure that competition rules are respected by either public undertakings or those to which Member States "grant special or exclusive rights." In its effort to break up national PTT monopolies, the Commission has employed this controversial weapon once and (if upheld by the Court) plans to do so again:

33. Terminal equipment

Status: adopted May 1988
Imp: immediate, but Member States have two and a half years to phase in deregulation

This legislation requires Member States to abolish over the next three years the exclusive rights they grant to their PTTs for the supply of terminal equipment. This includes second telephones (the first remains part of the PTT monopoly), telexes, modems, mobile telephones and PABXs (private automated branch exchanges). In other words, it will permit suppliers to deal directly with users rather than passing through the PTTs.

France has appealed to the Court of Justice regarding the use of Article 90 to introduce such an important piece of legislation. Although the French claim to support the aim of the directive, they argue that the Commission should have followed the normal legislative path.

34. Telecom services

Status: Commission proposal December 1988
Imp: ?

Although, as stated, the formal approval by the Council of Ministers is not required, in this case the Commission has accepted to consult with both the European Parliament and the Council prior to adopting the final text.

This proposal will require national PTTs to end their exclusive rights or monopolies over the supply of telecom services by 1991. The Commission has decided to exclude both telex and telephone-vocal services from the liberalization move, but the text would cover all other value-added services including facsimile transmission.

The directive will permit the final consumer or user of a service to deal directly with the service supplier by way of the latter's leased lines. The text will also require PTT authorities to separate their commercial activities in this area from their regulatory responsibilities.

COMPANY LAW

35. Structure of public limited companies (5th Company Law Directive)

Status: Under discussion in Council since 1983, but basically blocked over the question of worker participation on boards.
Imp: ?

This controversial directive was first proposed in 1972 and considerably revised in 1983. It seeks to harmonize the overall structure of public companies notably regarding the structure and role of their boards, participation of employees in management, rules governing annual general meetings of shareholders, and the adoption and audit of annual accounts. The legislation would affect all public limited companies -- quoted or unquoted on the stock exchange.

It would allow companies to adopt either a two-tier board structure or a unitary board. But in the latter case a clear distinction has to be made between the supervisory or nonexecutive members and the executive board members. Worker participation in management would be obligatory for all firms with more than 1 000 employees, but the proposal as currently drafted does provide four options ranging from participation introduced via a collective bargaining agreement to employee participation on the unitary board.

36. European Company Statute

Status: awaiting new Commission text; original proposal blocked over worker participation requirements
Imp: ?

This long-standing (1975) proposal is viewed as essential to the realization of the Single Market in 1992 because it would "facilitate and favor industrial co-operation and permit the creation of European corporations capable of competing on equal terms with their Japanese and American rivals."

The so-called Societas Europea (SE) would allow a company to unify under one legal entity the capital and personnel situated in several Community countries: it would not have to incorporate subsidiaries in each of the 12 Member States.

37. European Economic Interest Grouping

Status: adopted 1985
Imp: July 1, 1989

The EEIG is the first entirely European legal entity and is viewed as the first step toward the SE (see above). It is designed to facilitate transborder co-operation between companies by providing a common set of laws independent of any national legislation in which to incorporate the grouping. For multinational corporations the grouping would become a very useful instrument for setting up service companies to handle advertising, data processing, distribution, etc. for various European subsidiaries.

Although this regulation is directly applicable in the Member States, certain changes in national legislation are required in order to give an EEIG recognition. Internal market commissioner Lord Cockfield warned during the October 1988 Council meeting that many Member States had still not adopted the necessary changes.

38. Corporate groups (Ninth Company Law Directive)

Status: awaiting Commission proposal
Imp: ?

The idea for a directive establishing the responsibilities and rights of parent and subsidiary companies within a group has been around for over a decade. Initial drafts (based on the German legislation governing AGs) never made it past the Commission. Nevertheless such a directive remains part of the Internal Market program.

39. Cross-border mergers (10th Company Law Directive)

Status: EP first reading May 1987; sent back to committee
Imp: ?

This proposal seeks to facilitate cross-border mergers by harmonizing national rules affecting these types of mergers. It goes hand in hand with the third company law directive (1978), which harmonized rules regarding mergers between companies in one Member State.

40. Liquidation of Companies

Status: awaiting Commission proposal during 1989
Imp: ?

This proposal will harmonize national rules regarding the liquidation of companies.

INTELLECTUAL PROPERTY

A) PATENTS

41. Community Patent Convention

Status: blocked over question of partial implementation
Imp: ?

This agreement, signed in 1975, would introduce a patent valid throughout the 12 Member States. It takes the form of an intergovernmental convention, meaning that it does not follow the EC's legislative process.

Although the majority of Member States have ratified the convention, it cannot go into force in its current state until all countries have done so. Since Ireland and Denmark have constitutional problems regarding ratification, and since Spain and Portugal argue that they agreed to ratification during their adhesion talks provided everyone ratified the convention, the outlook for early approval is unlikely. An agreement may still be found with partial implementation taking place shortly after 1992.

42. Biotech inventions

Status: awaiting EP first reading
Imp: ?

This proposal would harmonize patent protection for biotechnology inventions throughout the 12 Member States in order to provide the legal certainty required for industries to develop in the biotech field. Existing national legislation is based on two international patent conventions dating from the 1960s -- a time when biotechnological processes were either nonexistent or in their infancy.

The Commission's proposal would authorize the patentability of a living organism provided that "a sufficient degree of human intervention has occurred." It then provides the traditional 20-year patent protection for biotech inventions. It also defines which biotech inventions are covered.

B) TRADEMARKS

43. Harmonization of national trademarks

Status: adopted December 1988
Imp: end-1992

This directive will affect all registered national trademarks covering both products and services. It provides a uniform definition for the signs or marks that can constitute a trademark as "any sign, mark or shape that can be represented graphically." It includes an exhaustive list of the acceptable reasons for rejecting or nullifying a trademark, as well as an outline of the rights and obligations of trademark holders.

The directive does not attempt in any way to harmonize national procedures for applying for trademarks, because the task would have been impossible. Instead the Commission hopes that in the not too distant future, the owner "who wants to register a trademark in more than one country will have the option of applying for a Community Trademark."

44. Community Trademark Regulation

Status: awaiting Council approval
Imp: ?

This regulation would introduce a Community Trademark valid throughout the 12 Member States. It is currently blocked, however, over the question of where to set up a Trademark Office.

45. Counterfeit goods

Status: adopted December 1986
Imp: Jan. 1, 1988

This directive introduces common rules and procedures empowering all customs officials to seize goods infringing registered trademarks imported into the Community.

A proposal extending the above legislation to goods infringing copyrights is expected for 1989.

C) COPYRIGHTS

46. Protection of software

Status: Commission proposal December 1988
Imp: ?

This is the first directive in the copyright field and calls basically on Member States to grant copyright protection to all software programs. It defines by what legal provisions programs should be protected; the person in whom and the terms and conditions under which the right arises; and the acts which require the authorization of the rightholder and those which do not.

47. Rules regarding audio-visual rentals

Status: awaiting Commission proposal during 1989
Imp: ?

This proposal will cover the whole question of renting copyrighted material, including what happens when copyright protection differs among the Member States.

TAXATION

A) CORPORATE TAXES

The following three directives form a package which has been blocked for almost four years due to a German-Dutch dispute on the level of withholding taxes to be allowed during a transition period in the parent-subsidiary taxation proposal:

48. Arbitration procedure

Status: blocked
Imp: ?

This proposal would be of major importance to multinational corporations in the EC because it would totally resolve double taxation problems. Member States would be required to eliminate double taxation in the adjustment or transfer of profits between associated enterprises. Where two governments cannot agree on the proper transfer prices between the companies, they would submit the case to an arbitration commission for an obligatory solution. Under the existing series of bilateral double taxation agreements among the 10 Member States (all based on the OECD model convention), signatories are obliged only to "endeavor" to reach agreement on transfer pricing.

49. Taxation of mergers

Status: blocked
Imp: ?

This proposal would introduce common systems of corporate and capital gains tax applicable to mergers, divisions and contributions of assets between companies of different Member States. It basically allows these firms to defer payment of the taxes that would be due when the merger or other operation takes place.

50. Parent-subsidiary taxation

Status: blocked
Imp: ?

The parent-subsidiary directive would establish rules regarding the taxation of profits or dividends transferred from a subsidiary in one EC country to a parent in another.

51. Carryover of losses

Status: awaiting Council CP
Imp: ?

This is the first proposal aimed at harmonizing the corporate tax base as a first step toward harmonizing the taxes themselves. Under this proposal firms would have a choice: losses could be carried forward to subsequent financial years without any time limit; or carried back to previous years, a technique which amounts in practice to a tax refund. Following criticisms from the Parliament, the Commission extended the carryback period to three years from the initial two.

52. Corporate tax base

Status: awaiting Commission approval in early 1989
Imp: ?

This directive will seek to harmonize the corporate tax base as the first step toward harmonizing the rates themselves. The proposal will deal with depreciation, capital gains and similar rules for stocks, provisions and reserves.

It will probably be accompanied by a Communication on Direct Taxation which will provide an outline for the Commission's activities in this field. The document may include a look into the Commission's views on tax incentives for activities such as research and development, but special considerations for small- and medium-sized companies and concern for R&D in Europe have helped delay this Communication for two years.

B) INDIRECT TAXES

53. Approximation of rates of VAT and excise duties

Status: awaiting EP first reading
Imp: ?

These major proposals, seen by the Commission as the cornerstone of the Internal Market Program, are certainly one of its most controversial elements. They seek to limit the number of VAT rates to two and to harmonize the levels of each within a certain band (4-9 per cent for basic necessities and 14-20 per cent for all other products).

Excise taxes on the other hand would be harmonized at fixed rates. Leaded gasoline for example would have a duty of ECU340 per thousand litres, while that for unleaded would be set at ECU310. The tax on cigarettes would be set at ECU19.5 per 1 000, and for alcoholic beverages ECU1 271 per 100 litres of pure alcohol.

Products would be taxed in the country where the sale takes place, with a clearing system among the Member States so that VAT payments become simply a balance sheet exercise.

The U.K. is leading the attack on these proposals, which it claims are not essential to the completion of the Single Market because computerization permits companies to pay the various rates without too many problems. Unofficially, other Member States with high VAT rates and tight budget-deficit-control problems are content with U.K. obstruction. Faced with such opposition, the new Commission will undoubtedly come up with a modified proposal drafted by new tax commissioner Christiane Scrivener.

COMPETITION AND STATE AIDS

54. Merger Control Regulation

Status: awaiting Council adoption
Imp: ?

With this regulation the EC Commission would receive prior vetting powers over large trans-European mergers. The proposal entails a major loss of sovereignty for the Member States and as such is viewed by the Commission as a priority for Council adoption. Despite the transfer of sovereignty, all Member States except the U.K. have agreed to the principle of such a regulation, but so far no Member State has agreed to the current text. Industry in general supports the idea of the regulation as well but has soundly condemned the circulating text. The draft regulation has been "hanging around" since 1973, but Council adoption is not likely for at least another 12 months.

Progress has been made, however. Member States now accept the exclusive jurisdiction of the Commission over Community mergers, although major disagreements persist over the definition. The Commission for example currently proposes that all mergers leading to a combined turnover above ECU1 billion should be subject to the notification rules, but the U.K. and Germany have recently proposed an ECU10 billion threshold.

55. Block exemption on know-how licensing

Status: adopted by Commission December 1988
Imp: April 1, 1989

This regulation will set the criteria by which know-how licences can escape the general Article 85 ban against anticompetitive agreements. The objective is to facilitate these agreements by providing necessary legal security regarding their compatibility with the Rome Treaty. Existing block exemptions (which do not require approval by the Council) cover distribution, specialization, R&D and patent agreements. The know-how rules are seen as a follow-up to the patent licensing block exemption.

56. Block exemption on franchising agreements

Status: adopted by Commission December 1988
Imp: April 1, 1989

This regulation would provide the do's and don'ts for franchising agreements involving the distribution of either goods or services. Like all block exemptions, it seeks to provide the legal security necessary to promote these agreements.

57. Inventory of state aids

Status: published by Commission December 1988

The Inventory provides an in-depth analysis of national practices on subsidies. The 90-page document shows that Member States spend almost ECU100 billion per year, with the majority going to the crisis or declining sectors. The Commission will use this analysis as the basis for stricter enforcement of existing state aid rules.

LABOUR RELATIONS

In the whole area of labour relations, the EC seems to be striving toward a solution that would establish European principles but would call for implementation according to national practices. Although no legislation has yet been proposed which reflects this approach, the Commission is redrafting various proposals along these lines. The approach was devised in the so-called "Social Dialogue" which brings together representatives from the European Trade Union Confederation and UNICE representing industry.

58. Information and consultation

Status: blocked, awaiting new Commission text
Imp: ?

Should the Community introduce harmonized workers rights to information and consultation, or should existing national practices be preserved? Opposition led by the U.K., with tacit support by most other Member States, led to a resounding defeat for the former approach in 1986. The Commission's new draft is based on a March 1987 agreement in the Social Dialogue introducing a less controversial requirement for information and consultation when new technologies are introduced.

59. Part-time and temporary work

Status: two proposals blocked at Council level, to be redrafted in one directive on contracts relating to "other than full-time employment."
Imp: ?

These proposals seek to assure on the hand that workers interested in this type of employment benefit from equitable insurance and pension rights, and on the other that workers are not forced to accept working under these limited employment schemes if they do not wish to. The issue will be how much job protection is compatible with employment creation.

60. Reduction and reorganization of working time (Recommendation)

Status: blocked
Imp: ?

This proposal sought to harness and accelerate the existing trends toward a shorter and more flexible workweek. The text recognized that the link between shorter hours and increased employment is not direct: in order to create jobs, a reduction in hours must be combined with a reorganization of work schedules to assure a flexible labour force and better utilization of capital equipment. In addition, unit costs must not rise if employment is to be created. The U.K. put a stop to the recommendation, claiming that it would give the wrong signal to the unions.

61. Personal protective devices (PPD)

Status: awaiting EP first reading
Imp: (1990)

This proposal introduces the obligation for employers to provide PPDs when they are unable to eliminate or adequately reduce collective risks for workers. The conditions for the use of PPDs depend on the degree of risk and the frequency of exposure to it. The equipment must correspond to the risk involved and be adapted to the individual worker.

62. Use of visual display units (VDUs)

Status: awaiting EP first reading
Imp: (1992)

This directive, which would apply to all companies, seeks to assure not only the appropriate design of work stations for VDUs but also the introduction of eye examinations. It also introduces a series of minimum standards for the VDU itself regarding the screen, keyboard, etc.

APPENDIX II

THE BUSINESS IMPACT OF 1992 SURVEY

Introduction

As part of its ongoing coverage of the EC's Single Market project and its impact on business, Business International recently undertook a mail survey to explore managers' current thinking on how the "1992 factor" will affect their industry and their own companies' future in Europe.

This report on the survey findings is based on questionnaires returned by 426 executives, of whom 357 represent industrial companies and 69 are in finance or other services. The sectoral breakdown was as follows:

Industry:	
Automotive	20
Chemicals	66
Construction	12
Electrical and electronics	40
EDP (computers etc)	20
Food, beverages and tobacco	28
Metals and minerals	16
Mechanical engineering	31
Machinery	23
Pharmaceuticals	34
Telecommunications	11
Other	56
Services:	
Banking and finance	21
Business services	30
Distribution	9
Other	9

By nationality, 164 of the industrial sample represent U.S. and Canadian multinationals, 123 EC-based companies, 56 EFTA firms and 14 Japanese or others.

Since the questionnaire was oriented mainly toward manufacturing activities, the service sectors are treated separately in the accompanying tables, and this group is not segmented by nationality.

1. Aspects of the Single Market Program

For industrial companies, the greatest positive impact of the Single Market program is expected to come from removal of technical barriers (obstructive national standards and regulations) and the creation of common EC standards in their place. American and Japanese firms put the greatest emphasis on these factors, which are most important for the telecommunications, EDP and machinery sectors; EC standards are also of special interest to pharmaceuticals, construction and building materials firms. However, a majority of respondents do not expect the practical effects of these moves to come through before 1995-2000 at the earliest.

By contrast, service companies expect the most important benefits to come from liberalized financial services and free movement of capital -- reflecting the weight of banking and finance in this group. Moreover, these aspects of 1992 (which are also viewed positively by industrial firms) are expected to come through more or less on time.

Other aspects were highlighted as special concerns for certain industries:

- Removal of customs frontiers: wholesale and retail distributors are the most interested, but also the most skeptical that this will be achieved by 1992.

- Opening up government procurement is of particular interest to EDP and telecoms suppliers, as well as business consultants. Not surprisingly, telecoms firms are also the most keen on deregulation of monopolies.

- Harmonization of VAT and excise taxes is a priority for the automotive and, again, the distribution sectors (although some in the latter expect to suffer from the VAT changes).

- A curb on state aids and subsidies is mainly of interest to the metals and minerals sector (particularly steel companies).

- Free movement of personnel is of top importance to business services -- a group that includes accountants, law firms and engineering consultants whose staff will benefit after 1992 from the mutual recognition of professional qualifications.

- EC external trade policies are of greatest interest to the telecoms, metals and minerals, and automotive sectors. While the first two view this aspect as a positive benefit, some (foreign) auto companies see it as a threat. Japanese firms are divided on how EC trade policy will affect them.

On every aspect of the 1992 program, the balance of opinion among respondents to the survey was overwhelmingly positive. Some 87 per cent of industrial and service companies expect positive impacts, against less than 10 per cent on the negative side. This remarkable confidence in the benefits of the Single Market program perhaps reflects the bias of the sample toward large companies that are already deeply involved in international business.

Even with such a sample, however, some pockets of unease do appear. The curbing of state aids and subsidies is of particular concern to some EC producers in such fields as electrical/electronics and pharmaceuticals; and as noted already, the nature of external trade policies concerns some Japanese firms.

Views are less optimistic about the probable timing of the 1992 program's impact on business. The earliest results are expected from removal of customs frontiers, and the freeing of capital flows and financial services. But some slippage from the 1992 deadline is predicted on most other fronts, with the longest delays for deregulating monopolies, harmonizing excise taxes, taming state aids and opening public markets.

2. Effects on Industry

The survey asked executives to predict the effects of the 1992 program on their sector, assigning a strong/moderate/negligible impact to a series of possible results. These were grouped under three headings: market changes, competitive effects and restructuring effects.

MARKET CHANGES. For industrial (but not service) firms, the main impact on the marketplace is expected to be a consolidation of their customer base, with fewer and bigger customers after 1992. As a corollary, consumer goods and food suppliers foresee a strong trend toward increased retailer buying power.

Growth of regional markets is another important effect, particularly for service firms. The highest "strong impact" ratings for this factor came from companies in the EDP, automotive, distribution, telecoms and business services sectors.

In some sectors (e.g., energy, metals, autos, electronics and insurance), respondents who expect a strong trend toward more homogeneous markets (the "Euro-consumer") outnumber those who stress continuing market differentiation. But in others the opposite view prevails (especially in building materials, distribution, EDP, banking and consumer goods).

COMPETITIVE EFFECTS. The impact of market integration will be reflected in lower production costs, where savings will come primarily from rationalization (e.g., in metals and machinery) and from greater economies of scale (in telecoms, autos, electronics etc.). Access to cheaper inputs will be of less importance, except for distribution firms.

Additional cost savings will be reaped in other areas. Lower transport and distribution costs are most important to producers of bulk commodities such as metals or forest products. Lower financing costs are less significant for industrial firms (except chemicals) but more so for banks and insurance companies.

At the same time, the Single Market will lead to increased intra-EC trade -- especially in hitherto protected national markets such as telecoms and computers, as well as business services. Parallel imports (in pharmaceuticals, cars and certain beverages and food products) will also get a strong boost.

Rising cross-border competition is expected to have three major impacts:

- a downward trend toward convergence of national price levels, for consumer goods in general and especially for those affected by parallel importing;
- strong pressure on profit margins across many sectors of industry -- particularly in pharmaceuticals, telecommunications, food/beverages/tobacco and insurance; and
- a shakeout of weaker firms (this was given the highest "strong impact" rating of any factor).

What role will non-EC companies play in all this? Strong increases in non-EC competition are expected in many branches of industry. Almost everywhere, this will take the form of direct investment rather than imports. As to the prospects of "Fortress Europe," Japanese and EFTA industrialists are the most worried about increased barriers to non-EC firms, while most EC companies discount this possibility. Fears of protectionism are strongest in the metals, telecoms, automotive and forest products industries, as well as banking and distribution.

The final issue under this heading was whether the completion of the Single Market will strengthen EC firms as competitors in third markets. Interestingly, EC firms themselves appear less convinced than their Japanese and EFTA rivals, although U.S. companies are even more skeptical. The strongest positive impact is expected in telecoms and chemicals, while EC optimists are hardest to find in forest products, pharmaceuticals and insurance (industries dominated largely by Scandinavian or Swiss competitors).

RESTRUCTURING EFFECTS. In order of importance for industrial sectors, restructuring effects are ranked as follows:

1) Rationalization and cost-cutting is expected to have the greatest impact in the automotive, metals and minerals, mechanical engineering and telecoms industries, as well as in distribution and insurance.

2) Greater specialization will be a dominant reaction in telecoms, mechanical engineering and business services.

3) Concentration of production will prevail in metals and minerals, food products and pharmaceuticals.

4) Cross-border investment will rise most strongly in banking and insurance, forest products, construction and building materials, EDP and food products.

5) Increased M&A activity will have the strongest impact in the banking and insurance, telecoms, construction/building materials and electrical/electronics sectors.

For service sectors, however, the last two items are ranked as most important.

3. Strategies for the 1990s

Question 3 was broken down into two parts. The first part, 3A, asked executives which aspects of company strategy or policy will be most affected by the Single Market program. Not surprisingly, the responses of industrialists to question 3A show the greatest impact on marketing and distribution. These are followed by new product development, purchasing, mergers and acquisitions (M&A) strategy and manufacturing. (For European firms, product development and M&A scored higher.) The 1992 program is seen as less immediately relevant for finance, human resources, corporate organization, and research and development.

Service companies also put marketing at the top of the list, followed closely by M&A and human resources.

In question 3B, executives were asked to review a series of strategy/policy options in 10 broad areas. The following highlights some of their responses:

Competitive strategies. Given an option between striving to become a low-cost competitor or pursuing product differentiation, an equal proportion of the overall industrial sample came down on each side (a few chose both). American companies tend to favour the low-cost strategy, while European (especially EFTA) firms prefer to seek out differentiated niches. Service firms also lean toward the latter.

Nearly two thirds of the respondents see Europe as part of a global market strategy. This is the majority view in all industry and service sectors except forest products and distribution. The proportion of globalists rises above 80 per cent in EDP, telecommunications and mechanical engineering.

Both industrial and service companies will put heavy emphasis on mergers and acquisitions in the coming years. The appetite for M&A is strongest among EFTA firms, and weakest among American firms looking at Europe. By sector, it ranges from over 90 per cent in telecoms, construction and building materials to only 40 per cent in the auto industry. European firms will be focusing mainly on cross-border acquisitions within the EC, as opposed to purely national moves or broader international forays to the U.S. and elsewhere. And the emphasis will be on horizontal acquisitions (buying market share) rather than vertical concentration or diversification.

Joint ventures and alliances are also a popular strategy, though less so than acquisitions (except for Japanese firms and those in the auto, electrical/electronics, EDP and telecoms sectors). Once again the preference is for cross-border linkups with EC partners, followed by alliances with non-EC partners and purely national deals. Only a small proportion are considering a review or termination of existing alliances.

For EC companies, the emphasis will be on expanding sales within Europe, and primarily through exports rather than investment (except for construction and distribution companies). By contrast, EFTA and American firms will stress expansion on the ground through local production, acquisitions and alliances; only 27 per cent of EFTA and 10 per cent of American companies see much scope for increasing their direct exports to the EC.

Organizational changes. Roughly half the respondents are planning to reorganize their European management in light of the changes in 1992 (U.S. firms being the most inclined in this direction), but a higher proportion foresee the need for more frequent organizational re-thinks in the future. Although the earlier trend toward closing down European regional headquarters appears to have run its course, the emphasis will continue to be on decentralization rather than recentralization, at least among European firms.

Production. The main trend here will be toward concentrating final production in specialized plants -- especially in the consumer goods and pharmaceutical sectors. Only the auto industry sees much potential for consolidating production of components in Euro-scale plants. The perceived need for plant closures is highest among EFTA firms and in the food and pharmaceutical industries, while the need to build new capacity is greatest in chemicals and in metals and minerals. Flexible manufacturing techniques are expected to play the greatest role in the machinery, mechanical engineering and automotive sectors.

Purchasing. The three most popular strategies in this area are to rationalize supplier networks, concentrate orders to maximize buying power, and cut in-factory inventory holdings. The auto industry is most interested in the first issue, telecoms in the second. Machinery and mechanical engineering firms are interested in all three. By comparison, only a third of the sample expect to emphasize more sourcing from other EC countries (except in mechanical engineering), and only one in eight is willing to cultivate single-source suppliers.

Marketing. The primary marketing focus will be on European market niches, particularly at the pan-European rather than national level (except for construction and service companies). Most consumer goods and food companies see scope for developing pan-European brands, while a third of food producers and distribution companies plan to emphasize growth of own-label products. Finally, about half of all industrial firms will aim for tighter control of marketing/service operations; this goal is especially stressed by consumer goods, automotive, EDP, and metals and minerals companies.

Distribution. The main thrust in most sectors will be to reduce delivery times and improve responsiveness to customers. While the general emphasis will be on extending distributor networks, EFTA firms and pharmaceutical companies are more interested in replacing distributors with their own sales companies. American and Japanese companies are more concerned than their EC/EFTA counterparts with centralizing physical distribution and using computer networks to track sales patterns.

Research and development. EC and EFTA firms are the most determined to increase R&D as a percentage of sales. Mechanical engineering is the only sector in which this was the majority response.

Few firms are inclined to decentralize R&D, although one in five electronics and telecoms companies have this in mind. By contrast, nearly half the sample aim to develop multinational R&D teams -- especially in the consumer goods and EDP sectors.

Not surprisingly, participation in joint research projects such as EUREKA is higher for EC/EFTA firms than American or Japanese; this is of greatest interest for those in EDP (ESPRIT), telecoms (RACE) and metals and minerals (EURAM).

If European firms are intent on boosting their R&D spending, they are also prepared to buy in or license technology -- particularly in pharmaceuticals and construction/building materials. EC companies expect to turn mainly to non-European licensors, while EFTA (and Japanese) firms will be drawing mainly on European technology. Those sectors relying more heavily on European technology sources are autos, energy, electrical/electronics and telecommunications; the converse is true for chemicals, EDP, metals and minerals, machinery and pharmaceuticals.

New product development. Reducing product development times is a key objective for about half the sample, particularly those in the mechanical engineering and auto sectors.

Growth in product ranges is expected to be particularly strong in consumer goods, telecoms and mechanical engineering. In most sectors, companies planning to extend their product range outnumber those planning to prune it. (Exceptions to this pattern are EFTA firms, as well as the energy and machinery sectors.) Similarly, those intending to diversify into new product areas outnumber those planning to shed non-core products or businesses (except in the auto sector).

Human resources. The main priority here is to develop pan-European management development programs; American and Japanese firms show the greatest interest in this effort, while European companies tend to focus more on increasing training budgets and language training. While few companies see a need for standardizing labour relations procedures across the Single Market, more envisage harmonization of benefits packages.

Finance. There is widespread interest in improving debt and exposure management and the use of innovative financing instruments. But despite the European Community's plans to liberalize banking and insurance services, fewer firms expect to change their banking relationships or reduce insurance costs. And only a quarter see much likelihood of denominating transactions in ECU -- a concept that appears to have least appeal for EFTA and Japanese firms.

4. Country Priorities

Asked to assess the various European countries as markets and investment sites for the 1990s, both industrial and service firms show a predictable preference for the larger countries.

This preference is least obtrusive when countries are rated as markets to be supplied from abroad. Among industrial companies, Germany has a slight edge over the other Big Five, but two small but rich EFTA markets -- Switzerland and Sweden -- are ranked alongside it. For service firms, the nature of their activities is reflected in a lower proportion of cross-border sales; but again Germany ranks first, followed at a distance by Belgium and Spain.

The scores begin to diverge more widely when it comes to ranking countries as production sites for domestic sales. On this criterion all the Big Five outweigh the smaller countries by better than 3:1, with the U.K. getting top marks from both industrial and service companies.

Finally, when countries are assessed as an export base, the Big Five once again dominate the ratings, although Italy is noticeably less popular among industrial firms. For service companies, the U.K. scores a clear lead and France gets a very low rating; this contrast applies both to banks and to business services.

When the industrial sample is broken down by parent-company nationality, the EC and EFTA groups naturally tend to favour their home countries as export bases, while American and Japanese companies show a preference for the U.K.. As a domestic market, the U.K. and France are top priorities for American firms, and Spain for the Japanese.

1. ASPECTS OF THE SINGLE MARKET PROGRAM

What aspects of the Single Market program, if achieved, could have a significant positive or negative impact on your business?

	Positive Impact		Negative Impact		Probable Timing		
	Major %	Minor %	Major %	Minor %	circa 1992 %	1995-2000 %	later %
INDUSTRIAL COMPANIES:							
Removal of customs frontiers	39	53	2	8	67	26	1
Removal of technical barriers	57	36	3	5	31	59	4
Creation of EC standards	51	38	3	10	29	55	9
Opening up gov't procurement	22	63	4	10	28	52	10
Approximation of VAT rates	18	67	3	11	32	53	8
Harmonization of excise taxes	19	69	4	7	23	58	11
Curb on state aids/subsidies	18	54	7	19	27	51	14
Free movement of labour/managers	24	67	2	8	49	41	3
Free movement of capital	42	54	1	4	58	31	3
Liberalized financial services	36	60	0	3	51	39	2
Deregulation of monopolies	24	60	3	9	22	57	14
EC external trade policies	23	49	5	21	36	50	5

1. ASPECTS OF THE SINGLE MARKET PROGRAM (cont.)

What aspects of the Single Market program, if achieved, could have a significant positive or negative impact on your business?

	Positive Impact		Negative Impact		Probable Timing		
	Major %	Minor %	Major %	Minor %	circa 1992 %	1995–2000 %	later %
SERVICE COMPANIES:							
Removal of customs frontiers	43	51	2	4	55	40	2
Removal of technical barriers	36	60	0	0	36	54	8
Creation of EC standards	44	44	2	10	42	48	4
Opening up gov't procurement	29	62	0	4	29	53	9
Approximation of VAT rates	17	66	4	13	23	60	4
Harmonization of excise taxes	15	70	5	8	18	60	13
Curb on state aids/subsidies	11	58	11	16	16	53	18
Free movement of labour/managers	49	45	0	4	51	36	2
Free movement of capital	68	27	0	2	61	30	4
Liberalized financial services	74	21	0	4	57	32	4
Deregulation of monopolies	42	51	0	5	16	58	19
EC external trade policies	33	43	11	11	22	59	9

2. EFFECTS ON YOUR INDUSTRY

	INDUSTRY			SERVICES		
	Strong %	Mod. %	Negl. %	Str. %	Mod. %	Negl. %
Market changes:						
° growth of regional markets	21	46	29	30	41	17
° rise of homogeneous "Euro-consumer"	20	41	34	18	35	35
° continuing market differentiation	15	46	31	33	32	21
° fewer/bigger customers	36	36	24	27	39	24
° increase in retailer buying power	22	32	37	23	29	30
Competitive effects:						
° lower transport costs	23	46	26	12	23	45
° lower distribution costs	24	41	30	15	29	38
° lower financing costs	18	45	33	29	32	29
° lower production costs:						
- through rationalization	29	41	25	17	24	41
- scale economies	29	36	29	21	38	27
- access to cheaper inputs	14	41	38	17	26	38
° increased intra-EC trade:						
- direct sales	21	48	24	21	29	27
- parallel imports	20	38	30	12	24	38
° convergence of national price levels (end to differential pricing)	43	32	17	23	24	35
° pressure on profit margins	43	41	13	35	27	24
° shakeout of weaker firms	49	35	13	50	30	11
° increased competition from non-EC firms	25	34	26	24	27	32
- through investment in EC	31	38	24	30	30	26
- through imports	15	34	41	11	21	44
° greater barriers to non-EC firms	22	43	29	26	29	27
° strengthening of EC firms in third markets	16	41	35	21	24	29
Restructuring effects:						
° increased cross-border investment	31	41	20	48	18	23
° increased M&A activity	30	40	18	56	18	12
° concentration of production	34	36	24	20	23	38
° more specialization	35	33	25	29	39	18
° rationalization/cost-cutting	44	38	13	32	30	21

3A. CORPORATE STRATEGIES FOR THE 1990s

Which aspects of your business will be most affected by the Single Market program?

	INDUSTRY				SERVICES
(% of replies)	Total	EC	EFTA	N.America	Total
Marketing	50	52	56	46	52
Distribution	44	45	45	44	20
New product development	29	34	37	22	38
Purchasing	29	26	24	31	11
M&A strategy	28	36	35	21	45
Manufacturing	28	27	32	28	4
Finance	25	29	21	23	29
Human resources	23	28	24	18	45
Corporate organization	23	27	10	25	29
Research and development	18	19	18	15	9

3B. CORPORATE STRATEGIES FOR THE 1990s (cont.)

Which of the following strategies or policies will be emphasized by your company?

(% of replies)	INDUSTRY				SERVICES
	Total	EC	EFTA	N. Amer.	Total
Competitive strategies:					
° cost reduction to become low-cost competitor	38	34	25	45	20
° (or) concentrate on product differentiation	38	38	52	33	41
° see Europe as part of global market strategy	65	72	58	64	61
° mergers and acquisitions (M&A)	71	76	88	61	67
– national	17	25	10	14	23
– cross-border	46	48	63	41	46
– in U.S., etc.	13	25	17	2	4
– horizontal	27	33	27	23	19
– vertical	13	15	13	10	9
– diversification	14	15	17	10	14
° joint ventures/ alliances	61	68	67	52	58
– national	13	16	13	10	17
– cross-border (EC partners)	44	50	42	39	48
– non-EC partners	19	27	25	12	14
– review/terminate existing alliances	8	10	6	7	3
(EC companies):					
° increase exports					
– to EC markets	63	63	n.a.	n.a.	47
– to non-EC markets	35	35	n.a.	n.a.	7
° increase investment					
– in other EC markets	45	45	n.a.	n.a.	23
– in North America	35	35	n.a.	n.a.	7
– in other non-EC markets	28	28	n.a.	n.a.	7
(non-EC companies):					
° increase direct exports to EC	15	n.a.	27	10	7
° increase production within EC	42	n.a.	50	38	21
° acquisitions in EC	37	n.a.	54	31	20
° alliances with EC partners	36	n.a.	46	31	16
Organizational changes:					
° reorganize European management	48	45	35	56	46
° shift from multidomestic to pan-European organization	45	42	37	49	46
° close European regional HQ	6	7	10	4	7
° decentralization	23	29	29	17	20
° recentralization	14	12	8	17	13
° more frequent organizational re-thinks	54	55	60	53	35

3B.) Corporate Strategies (cont.)

(% of replies)	INDUSTRY				SERVICES
	Total	EC	EFTA	N. Amer.	Total
Production:					
° concentrate final production in specialized plants	50	52	60	46	9
° consolidate component production in Euro-scale plants	25	20	21	31	6
° close some plants	23	22	38	19	3
° build new capacity	28	27	29	27	4
° implement flexible manufacturing techniques in assembly	36	37	33	37	10
Purchasing:					
° rationalize supplier network	51	50	50	53	14
° more sourcing from other EC countries	36	37	31	37	14
° concentrate orders to maximize buying power	42	41	37	44	17
° nurture "single source" suppliers	12	10	6	15	3
° cut in-factory inventory holdings	40	41	38	43	9
Marketing:					
° focus on Euro-market niches	70	67	73	70	72
- pan-European	48	48	40	50	45
- at national level	22	20	27	23	38
° develop pan-European brands	32	28	33	33	23
° growth of own-label products	21	28	21	17	13
° tighter control of marketing/service operations	51	49	56	50	33
Distribution:					
° extend distributor network	33	41	23	28	29
° replace distributors with own sales companies	22	20	33	18	5
° centralize physical distribution	33	22	29	41	10
° use computer networks to track selling patterns	38	31	33	43	25
° reduce inventories in distribution system	43	37	40	49	13
° reduce delivery times / improve responsiveness to customers	64	62	63	67	23
Research and development:					
° increase R&D as percent of sales	39	47	50	30	16
° decentralize R&D	11	11	10	9	10
° develop multinational R&D teams	46	48	52	43	22
° participate in joint R&D projects (EUREKA, etc.)	35	42	42	27	9
° buy-in/license technology	37	43	39	30	14
- from Europe	22	21	29	20	11
- from elsewhere	25	34	22	19	9

3B) Corporate Strategies, cont.

(% of replies)

	INDUSTRY				SERVICES
	Total	EC	EFTA	N. Amer.	Total
<u>New product development:</u>					
° reduce product development times	48	52	51	44	20
° extend product range	41	46	31	40	41
° (or) reduce variants	12	12	18	10	6
° (or) cut basic range but increase final product differentiation	16	17	27	12	9
° diversify into new product areas	38	44	29	33	44
° (or) shed non-core products/businesses	16	14	27	15	3
<u>Human resources:</u>					
° develop pan-European management development programs	61	53	47	71	56
° introduce standard labour relations procedures	13	11	14	13	6
° harmonize benefits packages	27	28	10	31	19
° redefine managerial responsibilities	39	34	33	44	36
° cut administrative staff	33	28	43	36	17
° increase training budget	48	51	49	47	53
° implement increased language training	47	55	45	40	55
<u>Finance:</u>					
° improve debt management/reduce borrowing costs	44	45	47	41	34
° improve foreign exchange/ exposure management	43	34	45	48	31
° cut insurance costs	24	22	27	24	16
° change banking relationships	21	25	18	19	14
° use innovative financing instruments	50	61	51	44	47
° denominate transactions in ECU	26	33	10	28	20

4. COUNTRY PRIORITIES

How do you rank the European countries, on a 1-3 scale, as markets and as investment sites for the 1990s?
(1 = top priority, 3 = little interest)

	Market to supply from elsewhere		Produce locally for domestic market		Export base for EC/other markets	
(% of replies)	1	2	1	2	1	2
INDUSTRIAL COMPANIES						
Big 5:						
France	36	24	34	17	21	23
Germany	39	19	33	17	25	18
Italy	33	24	31	16	18	17
U.K.	27	24	38	16	25	21
Spain	33	25	32	14	25	18
Other EC:						
Belgium	34	30	9	10	13	10
Denmark	33	23	6	6	6	5
Greece	28	20	7	8	4	7
Ireland	27	17	4	5	8	8
Netherlands	36	28	10	13	12	13
Portugal	27	24	9	13	9	11
EFTA:						
Austria	30	28	4	10	5	9
Finland	30	24	7	7	5	5
Norway	34	23	4	8	4	5
Sweden	38	24	10	10	6	12
Switzerland	39	24	6	10	6	11
SERVICE COMPANIES						
Big 5:						
France	25	25	32	11	8	20
Germany	35	13	35	20	18	20
Italy	23	27	27	13	18	8
U.K.	22	15	45	10	28	16
Spain	27	15	25	25	18	11
Other EC:						
Belgium	28	23	11	11	10	10
Denmark	13	30	8	15	3	8
Greece	11	16	10	13	3	8
Ireland	13	18	6	10	3	6
Netherlands	22	32	15	16	11	8
Portugal	13	28	10	13	6	11
EFTA:						
Austria	18	22	6	8	3	10
Finland	15	23	6	5	3	3
Norway	15	25	5	10	0	5
Sweden	25	18	8	13	6	8
Switzerland	23	20	10	20	6	10

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Notes

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