1992 IMPLICATIONS of a SINGLE EUROPEAN MARKET

Overview

1992

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1992

IMPLICATIONS OF A SINGLE EUROPEAN MARKET

OVERVIEW

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FOREWORD

The European Community (EC), with a GDP similar to that of the United States, is Canada's second-largest trading partner and source of investment and technology. Canadian companies therefore have a particular interest in the completion of the European Community's internal market. The goal of the Single Market program, or Europe 1992 as it is often called, is the complete removal of barriers to the movement of goods, services, labour and capital within the 12 states of the Community to create a dynamic and rapidly growing market.

External Affairs and International Trade Canada (EAITC) is pleased to present this study as part of a series of reports on the implications of a Single European Market on Canada's trading, investment and technology interests. The areas to be covered by these reports include:

Agriculture and Food Products
Consumer Goods and Cultural Industries
Telecommunications and Computers
Automotive Industry
Minerals and Metals
Forest Products
Defence, Aerospace and Transportation
Specialty Chemical Products, New Materials, Pharmaceuticals and Biotechnology
Industrial Products and Services
Financial Services
Fisheries Products
Professional and Consulting Services — Law and Accounting

These reports, prepared by Raymond Chabot International Inc., BIPE (Bureau d'Informations et de Prévisions Économiques) and Informetrica Ltd., analyse the trends, export impact, competition, investment implications and technological acquisitions arising from the EC Single Market of 1992.

This series of reports complements an earlier study published by EAITC, *1992: Effects on Europe*, which details the major economic and trade effects of the integration. Now in its third printing due to popular demand, the report provides a clear picture of the unification legislation and implementation measures and the general expectations and response of European industry.

Following the publication of these sectoral reports, EAITC will focus on subsectors of Canadian industry in which particular opportunities arise from the Single Market. These studies will go into much more detail on the trade ramifications specific to each subsector.

Together these reports, the overview presented in *Effects on Europe*, the sectoral analyses of this series of studies, and the subsector details of the next phase of Europe 1992 reporting, are not simply an information base for Canadian business people, but can be seen as a call to action. Europe 1992 is happening now. It will affect the way we do business. We have to know about it. And we have to plan to profit from it.

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LIST OF ACRONYMS AND ABBREVIATIONS

EC	European Community
EFTA	European Free Trade Association (present members are Sweden, Norway, Iceland, Finland, Austria and Switzerland)
F.R.G.	Federal Republic of Germany
FTA	Canada-U.S. Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
U.S.S.R.	Union of Soviet Socialist Republics
VAT	Value-added tax

EXECUTIVE SUMMARY

Europe 1992

Europe 1992 encompasses the efforts of EC Member States to revive the movement for a unified European Community market, and to hasten the movement's pace. The objective of Europe 1992 is to eliminate all non-tariff barriers to the free movement within the EC of goods, services, capital, and labour. Efforts to achieve this goal are based on the following criteria:

- **One principle.** The principle of mutual recognition of standards, diplomas, regulation of professions, etc.;

- **One rule.** The rule of a qualified majority, which will prevent a single country from blocking the Community decision-making process;

- **One target.** A 1992 deadline for a unified European Community market, and precise deadlines for adopting the 279 Directives necessary to achieve this objective. Until now, the deadlines for Directives have generally been respected.

As market integration draws nearer, companies within and outside the EC are preparing. These preparations have resulted in: a revival of investment in Europe; a broad-based corporate restructuring by way of mergers and acquisitions within sectors most strongly affected (banking, insurance, chemicals, agri-food, distribution, electrical and electronic industries, etc.); and a general reinforcement of EC companies as international players.

The movement towards unifying national markets and reinforcing a European as opposed to national policy perspective has been strengthened and broadened by two other significant events: the start of monetary integration (the Delors Plan), and the opening of the East and German unification.

Consequences for Canadian Firms

Overall, Europe 1992 has positive consequences for Canadian firms. Nevertheless, it also presents challenges and risks.

The positive consequences include:

- the overall improvement of economic conditions in the EC;
- easier and less costly access to the European market (despite problems for specific products);
- favourable conditions for Canadian firms with the means and the ambition to establish themselves in the EC.

The challenges and risks include:

- competition on the European market will intensify as European firms become more efficient, and non-European firms' interest in the EC increases;
- Europe 1992 will contribute to making European firms more competitive in the North American market and non-EC markets;
- a unified EC will constitute another major bloc in the increasingly globalized world economy. This will make it both more urgent and perhaps more difficult for Canadian companies to position themselves on the international scene.

These risks also have a positive side in that stronger European firms could invest more in Canada to reinforce their presence on the North American market.

Possible Strategies

Outside Europe, Europe 1992 mostly concerns large companies that already have an international strategy; few Canadian companies have these characteristics. However, small- and medium-sized companies, which principally form the Canadian economy, are also equipped to meet the challenges of Europe 1992. These companies' assets include experience operating in an open and highly competitive economy, the impetus of the Canada-U.S. Free Trade Agreement (FTA), and mastery of North American labour and management practices, which are increasingly being adopted throughout the world, notably in Europe.

The best strategy for Canadian companies is to establish and maintain an active presence in the EC. This will allow these companies to: understand and respond to the various national market differences; meet government procurement requirements and take advantage of the best merger and acquisition opportunities; and fully participate in the development of technology and standards.

Companies without a presence in Europe or with no European link cannot expect to be unaffected by Europe 1992 and by globalization in general. Sooner or later, increased competition will affect them. The best way for such companies to prepare for the coming challenges is to reinforce their presence in Canadian and North American markets, and eventually to take advantage of the wave of European entrants on the North American market by forming alliances.

PART I: THE CONTEXT

1. CANADIAN CONTEXT

1.1 Introduction and Canadian Company Overview

A larger, more competitive European economy poses both opportunities and challenges for the Canadian economy and for individual businesses. Through the early years of the 1990s, restructuring should be reflected in accelerated investment, and possibly some upward pressure on European interest rates and prices. Under these macroeconomic influences, increased European demand should provide increased export opportunities for investment goods and for consumer items.

Over the longer term, 1992 should make European industry more competitive and lead to larger real incomes. The latter will be positive for Canadian exporters to Europe, while the former should generate increased competition in the Canadian market, and elsewhere, from European suppliers. If Canadian producers respond positively to heightened global competition, the possibility of losing market share to the increasingly competitive European producers, both in Canada and abroad, will be diminished. If the challenge is not met, the result could be reduced sales of Canadian goods in Canada and in Europe. Effects are likely to vary significantly by sector.

Apart from export effects, European integration provides an opportunity for Canadian companies to enter Europe or to expand operations there. The restructuring of European industry should be particularly pronounced in chemicals, mechanical engineering, office machinery, electrical goods, motor vehicles and parts, sections of food processing, civil engineering, wholesale trade, and financial intermediation. In the longer term, aggregate costs of production are likely to be lowered by 5 to 8 per cent, providing a significant advantage to companies with an established production base in Europe. These cost savings are analogous to those anticipated for Canadian producers as a result of the Canada-U.S. Free Trade Agreement.

Taking advantage of Europe 1992 will require Canadian entrepreneurs and firms, both large and not-so-large, to develop detailed investment plans. Barriers to Canadian investment include:

- the scarcity of large, Canadian-based firms with trans-North American experience;
- the dominant position of non-Canadian firms in much of Canadian manufacturing;
- the need for Canadian firms to concentrate on meeting the challenges of the FTA.

Canadian firms generally do not rank among the world's largest, but some in forest products, mining and related manufacturing, telecommunications equipment and services, civil engineering, and financial intermediation do fit this description. And Canada is an "open" economy in which management has faced, for the last half century, competition in domestic and foreign markets. This will be increasingly true in the future, if Canadian industry adjusts to become more competitive in response to the FTA.

A capacity to respond to external events is part of Canadian corporate culture. Canadian mid-sized companies thrive in this environment, and have expanded into the U.S. and other markets. Further, for Canadian managers, gaining "world product mandates" from international headquarters will not be a novel experience. Finally, a comparatively large number of Canada's population are either immigrants or first-generation Canadians; together with our English/French heritage, this diversity could be a strength for marketing and operating in Europe. Despite these advantages, however, the ability of Canadian firms to compete with Europeans has eroded over the past decade.

1.2 Recent Events

The erosion of Canadian competitiveness was a significant element behind recent efforts to develop a more productive Canadian economy. The Government of Canada estimates that the FTA, sales tax reform, income tax reform, the Labour Market Development Strategy, deregulation and privatization should add 0.75 per cent to annual growth in the early 1990s by improving the productivity of labour and capital.[1] Deregulation of the energy industry in the mid-1980s, and more recently of segments of the transportation industry and of financial intermediaries, should have a reinforcing effect. The restructuring of the mining sector at the time of the 1982 recession has left the country with a rationalized metal and non-metal mining industry.

The FTA is particularly relevant in the context of an integrating Europe. As with Europe 1992, the FTA should promote significant restructuring of industry and increased investment at the start of the 1990s. Indeed, sectors that should realize substantial gains in productivity are similar for Canada and Europe, and include: food processing, furniture and fixtures, smelting and other primary metals, metal fabricating, electrical products, and chemicals.[2] In short, productivity gains achieved in most sectors in Europe because of economic liberalization should be approximately matched by similar gains in Canada following from the liberalization of North American trade. Obviously, firms that operate on both sides of the Atlantic should be considering the implications of both the FTA and Europe 1992.

2. RECENT TRENDS IN TRADE FLOWS AND INVESTMENT BETWEEN CANADA AND EUROPE

2.1 Trade

In 1988, Canadian merchandise exports to the twelve Member States of the EC amounted to $10.8 billion, or 8 per cent of total exports; imports from the EC amounted to $15.8 billion, or 12 per cent of total imports. Comparable figures for Japan were $8.7 billion of exports and $9.3 billion of imports. Exports to the U.S., Canada's largest trading partner, amounted to $100 237 billion in 1988; imports from the U.S. were $85 219 billion.

Exports to the United Kingdom account for about one-third of Canada's EC export total. In 1988, exports of more than $1 billion went to Belgium, France, West Germany, Italy and the Netherlands. Imports are more concentrated, with the United Kingdom, West Germany, France and the Netherlands being the dominant sources. Imports from West Germany have grown rapidly in recent years, and now approximate those from the United Kingdom.

The commodity composition of trade with the EC is a classic case of Canada supplying primary commodities in exchange for highly manufactured products. Over the past decade, the EC has been a consistently important market for fish and shellfish products, metal ores, softwood lumber, and wood pulp and paper products. Exports of semi-manufactured and highly manufactured goods are typically small; exports of highly manufactured goods (Section V in the trade nomenclature) total only about $2 billion.

In contrast, Canadian imports from the EC are dominated by manufactured goods. Canada is a notable market for EC exports of primary and semi-fabricated commodities such as beverages (wine), crude petroleum, fabricated textiles, organic chemicals, and rolling mill products. Highly manufactured goods dominate imports, however, accounting for approximately $8 billion, more than one-half of the total. Imports of industrial machinery and transportation equipment are especially significant.

The other notable trend in trade relations with the EC is the degree to which the Canadian trade balance has deteriorated over the past decade. In the final years of the 1970s, the accounts were either in rough balance or recorded Canadian trade surpluses. In 1988, the balance favoured the Community by almost $5 billion. This deterioration, from a Canadian perspective, is traceable to a number of factors. In part, it reflected the relatively poor economic performance of the country's principal Community trading partner, the United Kingdom: exports to the U.K. in 1986 were approximately the same, in absolute terms, as in 1979. Another factor was the considerable over-valuation of American and Canadian dollars from the late 1970s through to 1986. Since currency realignment in 1986, exports to Europe have grown relatively quickly, increasing from a low of 6.7 per cent of Canada's total in 1986 to almost 8 per cent in 1988. However, the trade balance was similar in both years, reflecting the high import content (i.e. increased machinery and equipment imports resulting from surging investment in Canada.)

2.2 Investment

International capital mobility can reflect the competitive success of an economy, as well as influence the development of that success. Canadian direct investments in the EC almost doubled in the early to mid-1980s when the Canadian current account balance recorded surpluses -- rare events in this century. Conversely, direct investment in Canada by EC nationals has almost doubled since 1985, reflecting the increased attraction of Canada and the

U.S. as bases for production since the 1986 currency realignment.

Direct investment in Canada by foreigners amounted to $110 billion in 1988. Of this, $23 billion was investment by EC nationals; those resident in the United Kingdom accounted for 60 per cent of this total. Data for recent years are unavailable, but mid-1980s data indicate widespread investment across sectors. Investment in financial institutions accounted for one-third of the total, as did investment in the petroleum, natural gas and non-energy mining sector. Another one quarter was allocated to manufacturing, dominated by food processing, chemicals, primary metals and forest-related processing.

Canadian investment is a small source of total EC investment funds. Nevertheless, the Canadian direct investment of almost $9 billion in 1988 constituted about one-sixth of all Canadian direct investment abroad. Approximately two-thirds of the Canadian EC investments went to the United Kingdom. Overall, 70 percent of Canadian EC investments are concentrated in manufacturing, especially in food and beverage processing, forest-related products, and primary metals. The balance of investment goes to petroleum and financial services.

As mentioned earlier, Canadian firms have an EC foothold in areas such as financial services, food and beverages, and mechanical engineering. Particularly strong civil engineering growth in Europe should also provide opportunities for large Canadian-based firms. In other areas where activity in the EC is expected to grow rapidly, or where significant restructuring is expected -- office machinery, electrical goods, and the automotive sector -- Canadian firms will face global corporations and will be more likely to find success in joint ventures.

3. "EUROPE 1992"

3.1 The Context

The European Community was launched by the 1957 Treaty of Rome, signed by Belgium, France, Italy, Luxembourg, the Netherlands and the Federal Republic of Germany (FRG). The first ten years of the Treaty's existence were characterized by a consistently rapid pace of adjustment. The adoption of a Common External Tariff, the abolition of customs duties on intra-Community trade and the establishment of the Common Agricultural Policy were all completed before the deadlines provided for in the Treaty. The results were almost immediate; the proportion of total exports of Member States into the European Community went from 35 per cent in 1957 to over 50 per cent in 1970.

In the 1970s and 1980s, the EC expanded considerably. The United Kingdom, Ireland and Denmark entered in 1973, Greece in 1981, and Spain and Portugal in 1986. However, the integration process itself made little progress. Although tariff barriers had been eliminated, non-tariff barriers (particularly standards) were used to limit imports from other Member States: the food and agricultural sectors were particularly affected by this problem. Furthermore, divergent value-added tax (VAT) rates necessitated costly and time-consuming border controls, public procurement remained under national control, and no significant progress was made on harmonization of professions or the right of establishment in the services sector. As a result, by the beginning of the 1970s, the proportion of intra-Community trade began to level off.

The first half of the 1980s were marked by Euro-pessimism. During the 1960s and most of the 1970s, the main continental European countries had growth rates considerably higher than the American rates. The 1980s, however, were characterized by diminished growth and high levels of unemployment. Furthermore, in the context of increasingly rapid globalization, European countries limited to narrow national markets appeared unable to hold their own against American and Japanese competitors.

These circumstances created a political context favourable to revival of European integration. The Single European Act was the result of this revival.

3.2 The Single European Act

The objectives of the Single European Act -- eliminating all non-tariff barriers, opening up public procurement, establishing freedom of establishment and the free movement of capital -- do not differ from those set forth in the Treaty of Rome. In fact, it has not been necessary to resort to a new treaty to launch Europe 1992. The Single European Act establishes, however, that EC Member States acknowledge a principle, a regulation, and a target that have quickened the pace towards a unified market, which in turn made it credible to set 1992 as the deadline.

a) Mutual Recognition

Before the Single European Act, most attempts to open the market focused on harmonization of standards, diplomas, regulation of professions, etc. as a prelude to liberalization. There were always particular interest groups that objected to some parts of the harmonization efforts and therefore delayed it. The famous ruling "Crème de Cassis de Dijon,"[3] established the basic principle of mutual recognition of standards, diplomas, regulations concerning professions, etc. Furthermore, for a limited number of sectors and domains, European standards and regulation have been universally imposed.

b) The Rule of a Qualified Majority

Before the Single European Act, all decisions had to be unanimous. The Act introduced the concept of a qualified majority for most decisions (tax measures, for example, still require unanimity) so that no single Member State could thwart the will of the other eleven.

c) A 1992 Target

The *White Paper*, the document containing the framework for the Single European Act, includes a list of 279 Directives[4] necessary to achieve a unified market. The *Paper* also fixes precise deadlines for the adoption of these Directives. By signing the Single European Act, Member States have committed themselves to this schedule.

d) The Regulations Mechanism

The Elimination of Customs Controls and the Harmonization of Indirect Taxation

Fiscal considerations are the main factor behind customs controls within the EC. The differences from country to country of VAT and excise tax rates results in numerous administrative formalities at the borders. In the short term, the single document for goods should considerably lessen procedures for companies (the expected gain is 2 to 3 per cent of the value of exports). In the long term, the harmonization of taxation, especially of the VAT, will have other effects. For example, in France automobiles will be less expensive (assuming all other factors remain constant). This could, in turn, revive the market.

Technical Standards

Because of the delays and difficulties associated with harmonizing technical specifications on a European basis, this will be limited henceforth to essential health and safety requirements. Mutual acceptance of national standards will be the guiding principle, except in specific sectors, such as telecommunications, for which European standards will be established, and where essential requirements Directives apply.

Public Procurement

Public procurement in the EC Community represents a market in the order of C$600 billion, which is about the size of Canada's GDP. Certain domains are theoretically already open to European competition, but these markets have in fact remained divided along national lines. Controls and sanctions will be established to attain greater intra-EC competition and to open new sectors (transportation, telecommunications, water, energy) to this competition.

Freedom of Establishment in Services

The non-discriminatory principle applying to goods will also apply to services.

Free Movement of Professionals

This freedom of movement assumes that qualifications and diplomas of the various countries will be mutually recognized. The freedom of establishment should allow professionals to practice in the country of their choice.

Free Movement of Capital

The free movement of capital should affect overall financial assets, whether monetary or securities. Money supply and prudential regulations will be under the control of the country in which the company is based. These measures require EC countries to achieve greater co-ordination of monetary and economic policies.

Corporate Law

Creation of European Economic Interest Groups (EEIG) has been possible since 1989. The definition and subsequent establishment of a status for European companies will be covered by the proposed European Company

Statute. These measures will go hand in hand with harmonization of company financial statements and the development of a European law on intellectual property.

1. *A Generally Accepted Schedule*

Despite difficulties, the schedule has been generally respected. This will likely continue although the 1992 deadline will, in specific cases, need to be extended.

The changes in Eastern Europe and the unification of Germany will affect the next step -- monetary integration -- more than market integration.

2. *A Strong Anticipatory Effect*

After an initial period of doubt, the Europe 1992 process became in 1987 a kind of self-fulfilling prophecy. Europe 1992 has become a determining factor in the strategy of companies not only within the EC, but also in the European Free Trade Association (EFTA) and in the U.S. and Japan. Within the EC, anticipation of 1992 has led to a strong increase in intra- and extra-EC mergers and acquisitions, a rise in investment to prepare for Europe 1992,[5] and an often considerable restructuring of certain sectors that had previously been extensively protected; these include banks and insurance companies, and suppliers of large public procurements such as railway and telecommunications equipment, heavy electrical equipment, and defence.[6]

Public procurement is still far from being open to intra-EC competition. Not all of the main Directives concerning public procurement have been adopted, and supplier/client relationships are such that it will undoubtedly be a long time before these markets will be subject to true competition. Nevertheless, in anticipation of coming changes and to profit from the free movement of capital and the liberalization of intra-EC takeovers, this sector has rapidly restructured around a few European leaders, where a dozen or more national leaders previously co-existed. Thus, the restructuring occurred around the French company Alcatel, the German company Siemens and the Swedish company Erikson for telephone exchanges, and around the Franco-British group GEC Alsthom and the Swiss-Swedish group Asea Brown Boveri (ABB) for railway equipment.

This does not mean, however, that the unified market will be completely homogeneous by 1992. Particular consumer habits will last for a long time, reflecting cultural and social differences. It would be unthinkable to expect the British, the Italians and the French to adopt identical behaviour patterns -- eating and dressing habits, for example. Similarly, advantages due to proximity and solid establishment in local markets will also continue. Recognizing this, the large suppliers of public procurements have established themselves in the major national markets by buying out existing firms.

4. CONSEQUENCES OF EUROPE 1992 IN THE EC

4.1 Macroeconomic Effects

Studies conducted by the Commission of the EC, known as "The Costs of Non-Europe" or the "Cecchini Report," predict four principal types of effects from the creation of a truly integrated internal European market:

(i) a significant reduction in costs due to a better exploitation of several kinds of economies of scale associated with the size of production units and enterprises;

(ii) an improved efficiency in enterprises, a rationalization of industrial structures and a setting of prices closer to costs of production, all resulting from more competitive markets;

iii) adjustments between industries on the basis of a fuller play of comparative advantages in an integrated market;

iv) a flow of innovations, new processes and new products, stimulated by the dynamics of the internal market.[7]

According to these studies, Europe 1992 should result in a medium-term cumulative reduction of consumption prices of about 6 per cent and in additional GDP growth of 4.5 per cent.[8] Moreover, all other factors remaining constant, intra-Community trade should be stimulated at the expense of extra-Community trade.[9] In addition, if the process is accompanied by coordinated macroeconomic policies by the various Member States, then additional GDP growth could be in the order of 7 per cent while the reduction of relative prices would be no more than 4.5 per cent.

It is impossible to compare these estimates to reality because the process is still in progress, and because it is methodologically impossible to determine which elements of the current macroeconomic evolution would be due to Europe 1992 and which would be due to other factors such as the improvement of the international economic environment or the results of structural programs by European countries since the early 1980s. However, it can be observed that, since 1986, the EC has generally experienced a revival. These trends will probably continue for the next two to three years, despite the net slowdown of the North American economy. The anticipations of directors of companies are generally positive.[10]

It would be quite misleading to attribute the end of "Euro-pessimism" solely to Europe 1992. The fact remains, however, that Europe 1992 has definitely been a significant impetus, especially with regard to investment. Moreover, Europe 1992 can explain in part why European prospects remain favourable while the North American economic environment is deteriorating. According to several analysts, the Cecchini Report may have been too conservative, underestimating the positive effects of Europe 1992.

In view of these studies and current observations, three macroeconomic observations can be made:

Greater Growth

Stimulated by Europe 1992, the EC is experiencing and will continue to experience for the next five years relatively sustained growth superior to that of the North American economy. Thus, the Community will be a more appealing market than it has been since the early 1980s.

More Competition

Because of the drop in prices, the EC will also be a more competitive and more difficult market. This will be reinforced by the increased interest of non-European firms (Japanese, Korean, American, and EFTA members) in the European market.

More Serious Competitors for Non-EC Markets

Finally, European countries, increasingly efficient in their internal markets, will also be more serious competitors in external markets, including those of Canada and the United States. Canadian firms should also become more competitive and should experience relative price drops as a result of the FTA.[11] The studies reveal that the effects of Europe 1992 in Europe should be greater than those of the FTA in Canada. The differences, however, will probably not be significant. In terms of competitiveness of Canadian and European firms on a global level, price variations would be negligible from the viewpoint of currency fluctuation. This might not be the case, however, for certain sectors. Finally, the current Uruguay Round of GATT negotiations should also contribute to reinforcing the productivity of certain sectors.

4.2 Effects on Sectors and Consequences for Companies

The consequences of Europe 1992 for different sectors in the European economy vary a great deal, depending on how the sector in question is affected by non-tariff barriers, restrictive public procurement policies and obstacles to the freedom of establishment or free movement of capital. To develop a better understanding of the effects of Europe 1992 on these various sectors, it may be useful to make a distinction between 1) direct effects, which are a direct result of increased market access due to the elimination of non-tariff barriers or declining production costs due to the greater mobility of factors; and 2) indirect effects, influenced by changes in the economic environment.

Direct Effects

To analyze the direct effects of Europe 1992 on various sectors, six criteria were used:

- elimination of border controls and harmonization of indirect taxes;
- harmonization or mutual recognition of standards;
- opening of public procurement and minimum state intervention;
- opening up of the service market;
- the free movement of capital, harmonization of corporate law and creation of a European Company Statute;
- the extent of European programs in Research and Development (R & D). While these programs are not explicitly part of the Europe 1992 process as defined by the *White Paper*, they are important accompanying measures.

The first three criteria can be qualified as downstream criteria because they are primarily related to demand and market access. The last three criteria are upstream criteria since they primarily affect conditions and costs of production.

Table 1 classifies sectors according to these criteria. It appears that the sectors most affected are:

- the food and agricultural industries, due to the extensive non-tariff barriers currently in place (border controls, problems with standards);

- heavy electrical industries, especially telecommunications equipment, due to the importance of public procurement and European R & D efforts in these sectors;

- services in general, since they have been strictly controlled by national regulations. The services particularly affected will be air transport,

TABLE 1

Direct Sectoral Effects of Europe 1992 in the EC

Industries	Removal of border controls tax harmonization	Technical standards	Public procure-ment	Services and labour markets	Liberali-zation of movement of capital and company law	European R & D programs (1)	Global evalu-ation
Agri-food	++	++	+		+		***
Energy	+	+	+		+		**
Iron and Steel			+		+		*
Metallurgy	+						-
Paper-cardboard		+					-
Glass		+					-
Chemicals		+				+	*
Plastic transformation	+				+		*
Heavy mech. and elect. equipment	+	+	++		+	+	***
Specialized mechanical equipment		+			+		*
Precision and medical equipment		+	+		+	+	**
Computer materials		+				+	*
Telecommunications equipment	+	++	++		+	++	***
Electronic equipment		+	+		+	++	**
Household equipment					+		-
Consumer electronics	+	++			+	+	**
Automobile construction	+	+				+	*
Aerospace construction		+	+		+	++	**
Naval construction			+				-
Pharmaceutical		+	+			+	*
Textile-clothing-shoes					+		-
Furniture	+				+		*
Publishing					+		-
Construction and public works		+	+		++		**
Services							
Air transport			++	++	++		***
Other transport			+	+	+		*
Telecommunication services		+	++	+	+	+	***
Retail trade			+	+	+		*
Wholesale trade	+			+	++		**
Professions			+	++	+		**
Services to firms			+	+	++	++	***
Banks	+			++	++		**
Insurance	++			++	++		***

(1) Though it does not particularly come under the Single European Act, we have added this sixth criterion to provide a global perspective of the effects on European construction.

Notation- per criterion
Nothing: little or no specific impact.
+: important impact.
++: very important impact.

An overall evaluation was obtained by adding the grades from each criterion using the following grid:

-: 0 or 1: little impact.
*: 2 to 3: noteworthy impact.
**: 4 to 5: important impact.
***: 6 or more: very important impact.

Source: BIPE.

telecommunications, banking, financial services and insurance.

However, sectors that are very important for the Canadian economy, such as the paperboard and metallurgical industries, will be minimally directly affected since they are not greatly influenced by non-tariff barriers and public procurement. Furthermore, European R & D efforts are not particularly concentrated in these sectors.

Indirect Effects and Company Strategies

Due to factors such as greater possibilities for an enlarged market, cost reductions in certain factors of production, competition transcending national boundaries, and facilitated intra-Community takeovers, European firms must face a profoundly modified economic environment. These firms have responded by moves towards significant restructuring and concentration to protect their share of national markets and to improve their positions vis-à-vis European and international markets.

The completion of the Single European Market is not the only force fostering concentration and external growth; increasing costs of R & D and of setting up in new markets, the role of financial markets and the globalization of the economy are also encouraging these developments. However, for European firms that are generally smaller than American or Japanese firms, Europe 1992 clearly represents the opportunity to grow from a national to a European or international level.

However, it must be emphasized that, depending on the extent of Europe 1992's direct effects and on the nature of initial circumstances, these consequences will not be the same in all sectors or in all countries.

Also, depending on the initial situation, the extent of concentration, of European and international integration, of competition and of EC dispersion all play important roles.

Concentration of National Supply

For a given sector, countries with large firms and a highly concentrated national supply will be less directly affected than those with a more atomized supply. Small firms will have to merge quickly to compete with bigger suppliers from other Member States. Moreover, they will also be very vulnerable to being bought by the latter. Thus, the United Kingdom's water distribution sector, initially very atomized, is experiencing an accelerated restructuring process in which French companies, through La Lyonnaise des Eaux and La Compagnie Générale des Eaux are playing an important role. Conversely, big British firms in the agri-food sector are dominating the restructuring of the more fragmented European scene. Similarly, the Spanish banking sector which, until now, had been minimally concentrated, is currently in the process of rapidly merging.

European and International Integration

For sectors that are already extensively Europeanized or internationalized, such as computers, re-organisation is minimal compared to sectors that have been operating primarily in national markets. This is the case for equipment suppliers for public procurement (telecommunications, heavy electrical equipment, railway equipment, etc.), the agri-food sector, and banking and insurance services. While the low level of national supply encourages primarily national mergers, the low level of international integration fosters intra-Community and extra-Community mergers.

Competition

Due to deregulation and the opening up of markets, initially highly regulated and protected sectors that experienced little competition, such as air transport (notably in France) are restructuring more than those that have had to operate in very competitive markets.

Comparable Performance of Member States

Clearly, the sectors with greater price and performance discrepancies among the various countries in the EC will be most affected. Many of these sectors are in the service industry: financial and insurance services, distribution, tourism, etc.

Table 1 summarizes, with examples, the main elements of this analysis.

The acceleration of mergers and acquisitions, of majority and minority shareholding acquisitions, and of joint ventures within the EC in the last half of the 1980s confirms the importance of restructuring and concentration.

Once again, it would be misleading to attribute this acceleration solely to Europe 1992. However, several facts confirm that the 1992 deadline amplified these developments. For example:

- the acceleration of mergers and acquisitions in the 1980s was stronger in the EC than in other parts of the world;

- EC-wide and international operations have experienced more growth than national operations;

- when asked to identify the reasons for increasing numbers of takeovers and joint ventures, heads of companies stated that reinforcing their position on the market was the main motivation behind mergers, acquisitions and majority takeovers, whereas R & D was the main motivation behind joint ventures. For the latter, EC-wide operations are increasing most quickly, which illustrates the extent of EC R & D efforts aimed especially at standing up to the Japanese challenge.

Finally, an analysis by sector reveals that the banking, insurance, distribution, chemical and agri-food sectors are accelerating most, while computers and extractive industries are minimally affected. These observations confirm the preceding conclusions.

4.3 The Acceleration of Foreign Investment in the EC

The Europe 1992 process has been accompanied not only by a strong revival of intra-EC investment, but also by an explosion of non-European investment in Europe, especially from the United States and Japan.

Direct American investment in the EC, as defined in the balance of payments, became positive once again in 1985, in contrast to 1983 and 1984. Moreover, the annual investment in the EC of American-controlled subsidiaries increased by more than 50 per cent from 1986 to 1989. Similarly, direct Japanese investment in the EC more than tripled from 1985 to 1987.

This explosion of extra-EC investment in the EC is taking place in a context of growing international investment. However, the proportion of American and Japanese foreign investment with the EC has substantially increased during this period, from 15 per cent to 19 per cent in the case of Japan and from 42 to 46 per cent in the case of the United States.

In both cases, the United Kingdom receives by far most of the investment.[12] Japan gives priority to Luxembourg and the Netherlands, while the United States gives priority to the FRG and France.

These divergences also reflect sectoral differences; more than 80 per cent of direct Japanese investment in the EC in 1987 was in the banking and insurance sector (which explains the importance of Luxembourg), whereas more than 60 per cent of direct American investment in 1988 was in the manufacturing sector.

4.4 Beyond Europe 1992: the Opening-up of Eastern Europe

The opening-up of Eastern Europe is, strictly speaking, beyond the scope of the Europe 1992 process. However, considering the enormous implications of this event on the EC, it would be difficult to conclude a study of the consequences of Europe 1992 without taking into consideration the developments in Eastern Europe.

The most probable consequences at the present time are the following:

- A considerable increase in EC exports to Eastern European countries: studies conducted by IFO[13] indicate that if Eastern European countries, which have conducted intra-Comecon trade until now, follow the common model[14] of other EC partners, then EC exports to these Eastern countries will likely multiply by three or four times by the year 2000[15] (in constant currency) and will likely surpass exports to North America;

- The strengthening of EC companies due to rapid growth in their investments in Eastern Europe and access to low-cost skilled labour;

- The possibility for EC companies to have access to certain natural resources in Eastern European countries (mines, forestry products, etc.).

The extent of these changes depends on the pace with which Eastern European countries are able to set up the foundations of a market economy. The ability to achieve such a goal cannot be taken for granted. Potential obstacles include the political risks of a backlash in the U.S.S.R. or destabilization due to renewed nationalism.

The consolidation of a market economy requires that:

- basic legislation be introduced guaranteeing the rights to private property and free enterprise;

- the productive system that has been dominated by large State-owned firms be restructured;

- the liberalization of prices take place in such a way as to not encourage an inflationary spiral.

Depending on the speed with which these adjustments take place, two basic scenarios can be foreseen. The first can be called the "valley of tears" because it envisages a long and chaotic transition that translates into depressed economic activity and a fall in per capita income for a significant part of the 1990s. In the second scenario, called the "rapid take-off," the adjustments would take place over a relatively short time, resulting in an immediate response from small local companies and in a propensity to invest from foreign companies. It would also permit a revival of growth in the first half of the 1990s.

Table 2 estimates the impact of EC exports to Eastern Europe according to these two scenarios. In both cases, the FRG would be the greatest beneficiary, since it accounts for more than half of EC exports to Eastern European countries.

The process of German unification should also reinforce European growth in the medium term. However, in the short term, the country's vast new capital needs and the Bundesbank's anti-inflationist policy could lead to slightly slower growth.

The question of the consequences of these developments on European integration is often raised. Some fear that they will act as a brake and a diversion to the Europe 1992 process. In-depth analysis of this issue remains beyond the scope of this study; however, it seems that the question will have to be raised primarily at the later stages of European Monetary Union and will only marginally affect the Europe 1992 process itself.

TABLE 2

Export Prospects from the EC to Eastern Europe — 1988

	Billion $US	Annual growth rate (%)	Share of EC exports (%)
1988	36.1		3.4
1995			
"Rapid Take off"	72.0	10.4	5.1
"Valley of Tears"	53.0	5.6	3.5
2000			
"Rapid Take off"	145.0	15.8	8.5
"Valley of Tears"	84.0	9.8	4.5

Source: *Europe in 1994.* BIPE, Cambridge Econometrics, IFO, Prometeia, January 1990.

In conclusion, and in the context of the previously conducted analysis of the consequences of Europe 1992, German unification and the opening-up of Eastern European countries will amplify the tendency towards revival of European growth and towards strengthening of EC firms. The tendency towards reinforcing intra-European trade (i.e., intra-EC and between various parts of Europe) at the expense of extra-European imports (all other factors remaining constant) may also be accentuated.

5. EUROPE 1992: CONSEQUENCES FOR CANADIAN FIRMS

Europe 1992 will have generally positive consequences for Canadian firms, although they will be faced with major challenges as well as certain risks.

The positive consequences are a result of:

- improved general economic conditions in the EC;
- general encouragement of easier and less costly access to the European market (despite problems for specific products);
- favourable conditions for Canadian firms with the means and the ambition to establish themselves in the EC.

The challenges and risks include:

- competition on the European market will intensify because of the increased efficiency of European firms and because of non-European firms' showing renewed interest in the EC;
- Europe 1992 will contribute to making European firms more competitive in North American and non-EC markets;
- a unified EC will constitute another major bloc in the increasingly globalized world economy. This will make it both more urgent and perhaps more difficult for Canadian companies to position themselves on the international scene.

These risks also have a positive side that stronger European firms could invest more in Canada to reinforce their presence on the North American market.

5.1 Improvement of Economic Conditions in the EC

Contrary to what may have been thought in the 1980s, the EC, stimulated by Europe 1992, German unification and the opening of Eastern European countries, will very likely be a centre of growth throughout the 1990s.

This implies export prospects for non-EC countries, but on the other hand it must be remembered that increased competition will prevail in the European market. Growth and profit prospects for firms that have established themselves in Europe are particularly good.

Furthermore, in recent years the European environment has become increasingly favourable to R & D and innovation, which is also an advantage for firms that are already established in Europe.

5.2 Market Access

Outside of the EC, the debate over Europe 1992 is often focused on market access. On the one hand, there is never-ending enthusiasm for potential opportunities arising from a single integrated market with all major obstacles to trade removed and with 325 million consumers. This is countered by the fear of an emerging bureaucracy animated by discriminatory intentions with regard to non-EC countries.

These two positions undoubtedly represent extremes. Two myths in particular must be dispelled: the idea of a "Fortress Europe" and the idea of a great homogeneous market shortly after 1992.

a) A Fortress Europe?

Americans first cried "Fortress Europe" in 1988, when it became clear that the Europe 1992 process was seriously progressing. Moreover, at the time, the United States was tightening its trade policy against its principal partners in an attempt to reduce its trade deficit. While some of the issues raised indeed justify vigilance and lobbying on the part of the EC's competitors, others have been exaggerated.

The main American fears centred on the following themes:

- the application of the reciprocity clause;

- the establishment of restrictive European standards with regard to non-EC countries;

- the rising strength of European firms in a process that places non-EC firms in the background.

The Reciprocity Clause

The debate over the reciprocity clause, intense and heated at one time, has now been reduced to more modest proportions.

The debate originated when sectors such as public procurement and many services, which have traditionally been very protected by national regulations but are progressively opening as a result of Europe 1992, wanted to know to what extent non-EC firms would benefit from the integration.

The European Commission's general response was that this would depend on the degree of reciprocity accorded to EC firms by the country of origin of the non-EC firms. There was some apprehension for a while, especially on the part of banks and the financial services industry, that this clause might be applied in a restrictive fashion; reciprocity could be interpreted as the imposition of rules even if they conflict with national regulations.[16] An even stricter interpretation would mean that the Commission could request that European firms have as much access to non-EC markets as non-EC companies have to European markets. After a period of uncertainty, this reciprocity clause was interpreted simply as a request for national treatment and questions relating to services and to general conditions of access to public procurement have been transferred to the GATT negotiations.

Standards and European Regulations

The two main bones of contention to this date have been hormones in bovine meat and the Directive concerning television content. Both cases shed light on Community procedures and on the extent of risks for non-EC countries, including Canada.

In general, the process of European integration is based on the principle of mutual recognition of standards. However, for a certain number of sectors, national standards will be replaced by European standards applicable to all Member States. These sectors are primarily in the area of health (particularly for food and agricultural products), safety, the environment and certain technical domains such as telecommunications equipment.

With regard to the first three domains, pressure from environmentalists (the "Greens"), particularly in Northern European countries, has led to European standards that are more restrictive than most national standards and, in some cases, more restrictive than North American standards. This is the case for standards on the use of hormones for animal feed, on irradiation of food and on labelling. In other cases, North American standards that are more restrictive than most European standards have been adopted (i.e., for polluting automotive emissions).

Because of their restrictive nature, some of the standards adopted or being prepared are detrimental to Canadian and American producers. These standards should be subjected to intense lobbying to limit their scope. However, it is important to understand that, in general, these standards are not the result of protectionist intentions against non-EC countries. They are the consequence of public opinion in certain European countries and of the power relations between consumers and producers. Some European producers will also be affected.

Stormy debates are taking place with regard to the technical and sanitary validity of some of these standards. However, just as certain American environmental standards were introduced and then were consequently imposed by European countries, it is possible that some of these European standards are premonitory of upcoming trends in North America.

In the case of the Television Without Frontiers Directive, fixed quotas of EC content are generally less restrictive than national laws or practices in the large EC countries.[17] It is clearly in the interest of non-European producers that these quotas be as low as possible, if not entirely eliminated. From the perspective of these producers, it would be legitimate to campaign against "European protectionism" since the Directive prevents them from using a small country -- with no national production to speak of and, therefore, no barriers -- as a kind of Trojan horse to spread into the rest of the EC. Even in this regard, though, the new Directive translates into a tendency towards reducing and not raising barriers, even if this reduction is considered to be insufficient from the American point of view. The EC position vis-à-vis Japanese automobile makers creates similar conflicts.

With regard to European standards and regulations, a final point deserves to be emphasized. The introduction of new European standards that differ from North American standards changes power relations in international standards and could, therefore, lead to some legitimate concerns. A European standard, as opposed to an isolated British, German or French one, has a greater chance of being imposed as an international standard. It is therefore in the interests of North Americans that these new European standards be as similar to their own as possible. Adapting North American products to the European market would then be less difficult and costly, and risks of EC standards being imposed internationally would be diminished.

These points justify the vigilance of North American public authorities and professional associations with regard to this process of elaborating European standards. The Europeans, however, maintain that they want to be open. To this end, they have offered to regularly inform non-EC countries of the work of the main European standardization bodies by making early drafts available to them for comments. These standardization organizations are the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standard Institute (ETSI).

The Rising Strength of European Companies

European officials have made no bones about the fact that because European firms are initially weaker than American or, in some sectors, Japanese firms, Europe 1992 is intended to primarily benefit and strengthen these European firms. The strengthening of European technological potential has been actively encouraged through European R & D programs. When it was in their power to do so, European authorities actively pushed towards European grouping of companies. The fact that controls on intra-EC mergers and acquisitions have relaxed while controls on extra-EC operations have remained unchanged encourages developments to continue in this same direction.

Large American firms, rightfully sensing that the reinforcing of European competitors represented a danger, applied pressure to take part in the restructuring.[18] The furor surrounding "Fortress Europe" was partly a reflection of this pressure and an illustration of the challenge that Europe 1992 might represent for large firms in non-EC countries.

Although the problem of stronger EC companies is real, it must be brought into perspective. As seen in the preceding section, international[19] mergers and acquisitions in the EC have also greatly increased since 1985, parallel to EC restructuring. Extra-EC investment, especially from the United States, also increased significantly. Moreover, sectoral reports reveal that in certain areas, such as professional and telecommunications services, American firms could be among the main beneficiaries of Europe 1992.

b) A Homogeneous Market shortly after 1992?

Opposed to the idea of a "Fortress Europe" is the myth of a great homogeneous market from which, immediately after 1992, all obstacles would disappear.

It is true that intra-EC border checks, with all their delays and additional costs, will disappear. This will permit the rationalization and simplification of production and distribution networks within the EC. The reduction of the size and the numbers of stocks will be possible as well. As a result, big manufacturers and distributors that operate in the EC -- whether they be from the EC or from non-EC countries -- have already begun to re-organize.

Certification procedures will also be considerably reduced, since it will no longer be necessary to be certified in all twelve Member States.

Finally, distribution networks are re-organizing on a European basis, which simplifies work and alleviates costs for extra-EC producers trying to distribute in the Community.

However, obstacles due to diversity in language, consumption habits, and close ties will not disappear for quite some time, although Europe 1992 will certainly have a reducing effect. Moreover, Europe 1992 will set the principles and the judicial framework, but in practice the actual opening of public procurement will be a slow process.

Finally, in certain sectors opening and deregulation will apply differently to EC and extra-EC companies. This will be the case for air transport and for public procurement, for which preference will continue to be given to EC companies.[20]

c) Market Access: Conclusions

In general, for reasons already discussed, Europe 1992 will contribute to easier and less costly (although more competitive) access to the European market as well as increased European market growth due to the improvement of general economic conditions.

However, for a limited number of sectors, notably telecommunications and agri-foods, standards or regulations are either moving away from North American practices or holding non-EC producers at a distance. The results of this could be disadvantageous for American and Canadian producers, and justifies vigilance by public authorities and professional associations.

In this regard, Canadian firms have the advantage of sharing the same general interests as American firms and, therefore, of benefiting from the surveillance and pressure imposed by American firms and by the American government.

5.3 Establishment Prospects

In many cases, the best way for Canadian companies to take advantage of Europe 1992 is not to rely on exports, but to establish themselves in Europe for the following reasons:

1. Certain regulations will favour EC companies

The liberalization of public procurement will apply only to companies with a 50 per cent minimum of Community content. Similarly, with regard to commercial policy, the Commission is determined to use certain means, such as the clause concerning the origin of content, to insure that minimal assembly plants be replaced by production establishments.[21] Furthermore, companies established in the

EC are consulted and are the first to receive notification when standards determined by the CEN and the CENELEC are set.[22] Finally, EC R & D programs are mainly intended to profit companies set up in the Community.

2. Distinctive national characteristics encourage local establishments

Europe 1992 is characterized by market unification while maintaining a significant number of national characteristics. This has the paradoxical result that numerous entrepreneurs who want to prepare themselves for the completion of the great internal market are eager to increase their presence in national markets by means of mergers, acquisitions, and the creation of joint ventures. This strategy also applies to extra-EC companies; in many cases, particularly for public procurement, local establishment is the best way to benefit from Europe 1992.

3. Rationalisation will primarily benefit companies set up in the EC

Factors such as renewed growth, rationalization, greater company profits and a favourable climate for innovation will chiefly benefit companies set up in the EC and will also stimulate intra-EC trade at the expense of extra-EC imports (all other factors remaining constant).

Sectoral reports (summarized in chapter 7) reveal that in most sectors, market shares dominated by non-EC country exporters, particularly Canadians, will likely be difficult to maintain after 1992, unless exporters choose to engage in joint ventures with European companies or choose direct establishment.

4. Restructuring opens prospects for Canadian firms to position themselves in the EC

Finally, and perhaps most significantly, Europe 1992 is provoking major restructuring and reshuffling. As a result, companies are attempting to strengthen themselves by engaging in alliances, mergers, acquisitions and joint ventures to improve their positions in EC and international markets. (See Tables 3 and 4.) Likewise, this process of alignment (which in some cases will only last a certain period of time) can present attractive opportunities for Canadian companies that are trying to achieve international standing, strengthen their technological potential and position themselves on international markets. Canadian companies that have worldwide ambitions in their sector and for their particular niche have quickly gained or extended their presence in the European market, often by buying out local companies and hence market shares.

5.4 The Risks

The risks resulting from increased competition between European companies in their own market and in non-EC markets have already been outlined. These risks can be of various types:

- greater difficulty for Canadian companies to preserve or increase their market share;

- greater difficulty for Canadian firms to acquire licensed European technologies because of the increasing aptitude of European companies to establish themselves directly in foreign markets and to develop their own technology. Canadian companies will find it particularly difficult to obtain licences with a mandate greater than Canada or North America.

Equally important is the risk for Canadian companies of being unable to keep up with an accelerating globalization process in which the other players -- American, European, and Japanese -- are strengthening and spreading themselves more rapidly than Canadians. This risk encourages Canadian firms to increase their size and develop an international

TABLE 3

Merger-Acquisitions, Partnerships and Joint Ventures in the EC by Sector — 1988

	National operations	European Community operations	International operations	Total
Banks	107	34	48	189
Chemicals	48	49	29	126
Agri-food	48	30	18	96
Insurance	32	21	34	87
Distribution	57	15	14	86
Paper	50	14	8	72
Electrical-electronic	41	13	17	71
Metallurgy	41	17	7	65
Materials and construction	37	19	4	60
Mechanical	38	5	15	58
Miscellaneous	21	6	9	36
Transport material	12	14	4	30
Mining	17	5	7	29
Textile - clothing - leather - shoes	16	5	2	23
Computers	5	2	2	9

Source: Commission of the European Communities, *Report on Competition*, 1986 - 1989.

TABLE 4

Merger-Acquisitions, Parnerships and Joint Ventures in the EC — 1985-1988

	1985	1986	1987	1988
National operations	313	345	448	570
European Community operations	99	116	147	249
International operations	68	101	113	218
Total	480	562	708	1 037

Source: Commission of the European Communities, *Report on Competition*, 1986 - 1989.

strategy by taking advantage of opportunities arising from the FTA, by developing establishments or joint ventures in Europe, or by being bought out themselves by European companies whose will to internationalise is stimulated by Europe 1992.[23]

Analysis of the evolution of EC direct investment in Canada and in the United States confirms that European companies are strengthening in North America. From 1984 to 1988, direct investment stock originating from the EC increased by 82 per cent in Canada and 101 per cent in the United States. Canada, therefore, is in a strong position to attract European companies that wish to get a foothold in the North American market (see Table 5).

As we have already outlined, this strengthening of European companies implies risks for Canadian firms. However, it may also represent good fortune, since these investments contribute to reinforcing Canada's economic fabric and technology potential and may result in good business deals for Canadian companies being acquired.

TABLE 5

Direct Investment from the EC to Canada and to the U.S. — 1984-1988

Canada (C$ billion)

Origin	1984	1985	1986	*1987	*1988	Growth 1984 / 1988 (%)
EC	12.7	13.6	17.4	19.4	23.1	82
All countries	78.8	82.0	90.7	100.4	110.3	40
EC/Total (%)	16.1	16.5	19.2	19.3	20.9	

* Estimates

Source: *Survey of Current Businesses*, U.S. Department of Commerce.

United-States (US$ billion)

Origin	1984	1985	1986	1987	1988	Growth 1984 / 1988 (%)
EC	96.6	107.1	127.2	165.4	193.9	100.7
All countries	164.5	184.6	220.4	271.8	328.9	99.9
EC/Total (%)	58.7	58.0	57.7	60.9	59.0	

Source: *Survey of Current Businesses*, U.S. Department of Commerce.

6. THE REACTIONS OF CANADIAN COMPANIES

6.1 A Limited Response from Canadian Companies

Canadian direct investment stock in the EC stagnated in the early 1980s, but increased by 66 per cent from 1984 to 1988. The share of total Canadian foreign investments allocated to the EC also increased, from 6.7 to 8 per cent. This illustrates that interest in the EC on the part of Canadian companies has been greater than their interest in the rest of the world.

This increase of Canadian investments in the EC was somewhat weaker than American investments in the EC, which have also increased relative to total American foreign investments (see Table 6).

TABLE 6

Direct Investment from Canada and the U.S. in the EC — 1984-1988

Canada (C$ billion)

Destination	1984	1985	1986	*1987	*1988	Growth 1984 - 1988 (%)
EC	5.3	6.6	7.1	8.0	8.8	66
All countries	78.8	82.0	90.7	100.4	110.3	40
EC/Total (%)	11.9	13.1	13.4	14.1	14.5	

* Estimates

Source: Statistics Canada.

United States (US$ billion)

Destination	1984	1985	1986	1987	1988	Growth 1988 - 1984 (%)
EC	72.1	83.9	98.6	120.1	126.5	75
All countries	211.5	230.3	259.8	308.0	326.9	55
EC/Total (%)	34.1	36.4	38.0	39.0	38.7	

Source: *Survey of Current Businesses*, U.S. Department of Commerce.

Canadian companies, like their American counterparts, have begun to respond favourably to the EC's improving economic conditions and to the prospects of Europe 1992. However, the share of Canada's total foreign investments in the EC is only 8 per cent compared to almost 40 per cent for the U.S. The total growth of Canadian investments in the EC from 1984 to 1988 is more than 25 times less than that of American investments over the same time period (C$2.5 billion compared to US$54.4 billion).

This means that, proportionate to the size of their economies, the increase of Canadian investment in the EC remains three times less than that of American investment. Sectoral studies confirm the relatively limited Canadian response to Europe 1992.

However, most already internationalized big companies, which often have bases in Europe (such as Bombardier, Northern Telecom, Seagram or McCain), have defined their strategy for taking advantage of Europe 1992. This strategy is usually to strengthen their presence in Europe, by mergers or acquisitions, to improve their position in target markets.

Certain medium- and small-sized firms, particularly in technological sectors such as computers or telecommunications equipment, have also adopted measures to reinforce their presence in the EC or to increase their exports to Europe.

However, in most cases, Europe 1992 is not currently a priority for Canadian companies and professional associations. Generally speaking, those that do manifest an interest in Europe 1992 are still waiting and are not establishing specific strategies. Several factors can explain this:

- The companies that will be affected most directly -- or at least at first -- by Europe 1992 are large-scale firms. Large companies in the EC, which have been primarily national until now, are hoping that Europe 1992 will enable them to acquire European and international dimensions. Large non-EC companies in non-EC countries are directly affected by this redeployment and by the accompanying opening of markets. However, large Canadian companies are not very numerous and are to a large extent restricted to certain sectors (mines and resources, forestry products, engineering). In many other sectors, the most important Canadian companies are subsidiaries of American companies, and for these, Europe 1992 strategies are elaborated by the parent company;

- Some of the strong sectors in the Canadian economy (mines and resources, forestry and fishery products) are in fact affected to a relatively minor extent by Europe 1992. On the other hand, Canadian supply is weaker in sectors such as agri-food and public procurement, in which the impact of Europe 1992 in the EC will be significant;

- For many companies, and especially for small- and medium-sized ones, the United States and the FTA are presently mobilising all their forces;

- The companies most capable of benefiting from Europe 1992 are those already established in the EC. However, the degree of establishment as well as the level of exports of Canadian companies in the EC is relatively limited. Moreover, Canadian bases are primarily concentrated in the United Kingdom and Ireland (which receive 70 per cent of Canadian EC investments).

In general, Canadian companies' response to Europe 1992 is conditioned by the structure of the Canadian economic fabric and by the characteristics of its international standing. Traditionally, this position was established through Great Britain, then through the United States. To benefit from Europe 1992, this position must be broadened.

Sectoral studies indicate that in some service sectors (i.e., professional and financial services), Canadian companies have certain advantages compared to companies in continental Europe. These advantages could be useful in the globalization of the economy. In general, however, the international strategies of these sectors remain relatively cautious, keeping in the shadow of their American and British counterparts. The caution of these Canadian companies can be explained in part by the fact that big Canadian businesses have traditionally chosen to resort to American or, to a lesser extent, British service firms for a significant part of their international operations. One of the positive outcomes of Europe 1992 may be to confirm to Canadian companies in the most exposed sectors that they need to adopt a daring international strategy to survive, and that they have advantages over their European partners, especially in continental Europe.

6.2 Possible Strategies

In a summary report, it is difficult to take into consideration all possible strategies for Canadian firms. This report will, therefore, be limited to general conclusions. For more detailed analysis, the reader may refer to the next part of the report and to the sectoral reports.

Companies in Rapidly Internationalizing Sectors Cannot Ignore Europe 1992.

Europe 1992 is only one element in a more general trend towards globalization and internationalization of the economy; it is the European response to this trend. For this reason, contrary to sectors that can continue to prosper in regional markets, industries that by nature will be greatly affected by this internationalization and globalization process (and their numbers continue to grow) simply cannot ignore the changes in their economic environment induced by Europe 1992. This conclusion is gaining ground among affected industries. However, the means to carry this internationalization process through to a successful conclusion is less evident.

An Incentive for Reinforcing Canadian Companies

Europe 1992 and the general internationalization context in which this process is taking place, are strong incentives for Canadian companies to expand beyond local markets. This would enable them to increase their investment and R & D capability, their means of conquering new market shares (or of maintaining their current ones), and of establishing themselves in international markets. This strengthening is most often a result of external growth (mergers, acquisitions, joint ventures) and can be carried out at the Canadian, North American or European level.

The deregulation currently under way in Canada in professional services (business consultants, lawyers, chartered accountants) and financial services, and the accompanying mergers and acquisitions, fit into these dynamics.

In sectors with primarily medium-sized Canadian companies, questions arise with regard to how these companies will be able to reinforce themselves without being bought out by foreign firms.[24]

Creating favourable conditions for this strengthening would be a significant way for the government to assist Canadian companies preparing for Europe 1992 and for the larger internationalization process.[25]

Niche Strategies

The best way to take advantage of Europe 1992 is to have bases in the EC and to reinforce this presence. This is the conclusion of Canadian companies with clearly defined strategies concerning Europe 1992 and with the means to implement these strategies. Such strategies are not decided upon lightly because even though Europe presents new opportunities, it also represents an increasingly competitive and therefore difficult market.

Canadian firms often lack the size necessary to be among worldwide leaders in their sectors. Therefore, their internationalization and, more precisely, their successful establishment in Europe, depends on very targeted niche strategies. This must be supported by extensive knowledge of the markets and their main actors, which in turn depends above all on being established on location.

Despite the current unification process, the single European market will remain characterized by significant distinctive features. Depending on the Member States and on the initial circumstances of the sector in each of these states, all entries will lead to an enlarged and more accessible market; however, they will not all be equal.

Companies Without European Bases

For companies that are not established in the EC, the effect of Europe 1992 is more uncertain and varies by sector.

If these companies are already exporting to the EC, they will benefit from simplified access to the market as a result of the rationalization of distribution networks. They will also find themselves in a more competitive market further courted by non-EC companies, and in which rationalization efforts will benefit intra-EC trade and companies set up in the EC at the expense —all other factors remaining constant — of imports. The stronger their ties with European companies and their understanding of the markets, the more these companies will benefit from the advantages and be in a position to face increasing competition resulting from Europe 1992.

For companies that are not currently exporting and that pursue essentially regional markets, the immediate concern is no doubt to make the most of the FTA with the United States. However, for those that find themselves in rapidly internationalizing sub-sectors, it would certainly be in their best interests to immediately position themselves in relation to the European market and to their competitors across the Atlantic. For subcontracting companies, which are an important part of Canada's economic fabric, one positive way of positioning themselves might be to try to learn from Canadian project managers with whom they have ties and who are presently reinforcing their positions in Europe.

Getting the Most Out of the Strengthening of European Companies in Canada

From 1984 to 1988, Canadian direct investment in the EC increased by $2.5 billion. However, in the same period, EC direct investment in Canada increased by $10.4 billion. This means the strengthening of European companies in Canada appears to be considerably greater than the strengthening of Canadian companies in Europe. It is possible, therefore, that for Canadian firms the consequences of Europe 1992 might be most significant within Canada. Responses might include defence strategies to maintain market share; alliance or merger strategies with other Canadian companies, or with European companies set up in Canada; or positioning strategies in significantly internationalized leading firms that are setting themselves up in Canada.

PART III: SECTORAL OVERVIEW

7. IMPLICATIONS OF EUROPE 1992 BY SECTOR

7.1 Agriculture and Food Products

a) Consequences in the EC

The agri-food industry, because of its history and current situation, will be significantly affected by Europe 1992.

Although a common EC agricultural policy has promoted the tariff-free circulation of agricultural products within the EC, processed products continue to be impeded by a diversity of standards, norms and controls. As a result, this sector is characterized by domestic rather than multinational firms, a multitude of small businesses, serious overcapacity and limited efficiency.

By opening interior borders through harmonization or common acceptance of norms and standards, Europe 1992 is seeking to set the stage for greater efficiency in the industry. Restriction-free access to a potential market of 325 million inhabitants should promote concentration and economies of scale.

b) Consequences for Canadian Firms

The Canadian agri-food industry has relatively few contacts with the European Community, either through exports, imports or investments. Canada's principal export market has been the United States and free trade will likely increase this trend. However, Europe 1992 and its consequences could add a new dimension. New opportunities include:

- possible access to a market of 325 million inhabitants with common standards and norms;
- ability to enter the market as a result of the move towards merger and concentration;
- development of interesting niches due to greater world standardization in consumption trends.

Risks include:

- influenced by the Green movement, standards (phytosanitary standards, veterinary controls) will be more restrictive for non-EC exporters;
- Canadian industries will face stronger competition, in Canada and abroad, from European agri-food products.

c) Possible Strategies

In the face of these possibilities, the Canadian agri-food industry should seek to adopt the following strategies:

. invest rapidly in the EC, thus benefitting from a greater ability to penetrate the market and from better acquisition or participation opportunities;

. begin exporting to the EC. Firms already doing business in the EC, and whose product is doing well, should not be adversely affected by Europe 1992. On the contrary, they should be in a position to expand their market share. Firms not currently in this market but who would like to benefit from the Single Market should rapidly enter one of the national markets; that is, identify the best country, niche, partner in a distribution network, and commercial agents;

. protect its share of the Canadian market and other traditional export markets. For many Canadian businesses, this means increasing efficiency and adopting international standards. Canadian businesses must already contemplate such measures because of the FTA, and this could give them an advantage over potential European competitors.

7.2 Consumer Goods and Cultural Industries

a) Consequences in the EC

Non-tariff barriers that have impeded trade of many consumer goods within the EC were for the most part border controls. The principal measures of Europe 1992 affecting these sectors are the elimination of border controls and the liberalization of capital movement. These two measures will engender the re-organization and the Europeanization of distribution networks as well as a certain amount of concentration among production companies.

However, in certain sectors such as consumer electronics, harmonization or mutual recognition of standards and the setting up of European R & D programs (such as high-definition television), will contribute greatly to the strengthening of European leaders (Electrolux, Philips, Thomson), giving them a worldwide dimension.

However, aside from the impact of easier intra-EC mergers and acquisitions, the progressive replacement of national and European cultural industry regulations (as in the case of the Television Without Frontiers Directive) represents a decisive step, the outcome of which, in the eyes of many, is uncertain. The impact of this step on non-EC countries will require further examination.

b) Consequences for Canadian Companies

The Europe 1992 process will make life simpler for Canadian companies doing business in Europe, but it seems that it will only be of substantial benefit to manufacturers with strong, recognized brand names.

In consumer products, major opportunity would seem to exist for Canadian industries that have products with a worldwide scope in sectors not yet subjected to concentration effects, and where EC company sizes are similar to Canadian companies (i.e., the office furniture industry). Sectors in which Canadian products set the standard (ice-hockey equipment, fur apparel) will also do well.

With cultural products, the historical Canadian multilingual environment and high level of productivity in the audio-visual field should create some opportunities for Canadian producers and production companies in the rapidly expanding EC audio-visual market. This opportunity may be limited, however, by the relatively small size of Canadian companies.

In publishing, Canadian firms' main opportunity resides in small specialty markets requiring a high value-added content; these markets favour smaller companies. In the recording industry, there would seem to be little opportunity outside of individual talents benefiting from a newly integrated, structured and expanding EC market.

In all three sectors, French-speaking talents and businesses may have a better opportunity than their English counterparts because of the market size of France.

c) Possible Strategies

In general, for Canadian firms to take advantage of Europe 1992, they will have to seriously evaluate benefits against substantial direct and hidden costs such as management and financial strain. These benefits must then be weighed against what similar efforts might bring in a market more culturally attuned and easier to service, now available with the FTA. Unless they have a product with a worldwide appeal, it is unlikely that Canadian firms will derive short-term benefits from Europe 1992.

7.3 Telecommunications and Computers

a) Consequences in the EC

Europe 1992 will have a great impact on the telecommunications and computer industries. One of the objectives of Europe 1992 is to ensure the development of a European information economy in which EC firms would become international leaders.

The principal result of Europe 1992 will be the reduction or removal of technical obstacles (compatibility of equipment, standards, regulations and access to public markets) that have fragmented European goods and services markets. Many Directives relating to the harmonization of standards, the clarification of regulations, and the opening of public markets to all EC firms have either already been adopted or are presently under review. The EC will very likely succeed in creating a single market for most products and services in the telecommunications and computer sector. European companies such as Siemens, Alcatel and Philips are already restructuring to benefit from economies of scale and from greater opportunities for specialization.

b) Consequences for Canadian Companies

Growth of investment in the EC, partly as a result of the harmonization of standards, the simplification of certification procedures, the opening of public markets and restructuring efforts represent greater and more accessible outlets for Canadian firms as well as new business opportunities. However, preference in the public markets will continue to be given to firms able to provide products with a 50 per cent EC content.

The main sub-sectors in which Canadian companies should be able to find niches thanks to technological and commercial know-how are telecommunications equipment (particularly end-user equipment), software and service companies.

c) Possible Strategies

To take maximum advantage of markets created by Europe 1992, Canadian companies in the telecommunications and computers sector will have to create a presence in Europe. To benefit from a unified European market, even small- and medium-sized Canadian companies will have to adopt a multinational character.

Companies that do not penetrate the European market may eventually be out-competed by international-scale companies based in Europe that will be in an advantageous position to conquer sections of the North American market.

In short, Europe 1992 will test the ability and the will of Canada to compete at the international level. To succeed in Europe, Canadian companies will need to establish and maintain an active presence in marketing to respond to the various national market differences; in production to meet procurement policy requirements; and in product development to participate fully in the development of technology and standards.

7.4 Automotive Industry

a) Consequences in the EC

The principal Europe 1992 measures that affect the automobile industry are: the removal of border controls to reduce distribution costs; the harmonization of VAT rates to stimulate demand in countries where rates are highest (i.e., Italy, France); the recognition of mutual standards to reduce the costs of adapting models to different markets; the strengthening of automobile safety controls to stimulate the demand for replacements; and limits to government aid, which will accelerate regrouping and rationalization within the industry.

b) Consequences for Canadian Companies

Canadian companies should benefit from the increase in demand resulting from improved general economic conditions in the EC and from the specific regulatory changes previously enumerated. Canadian products that have found a niche in the market, such as mini-vans and jeeps, should particularly benefit from increased demand.

Despite a certain degree of uncertainty, it seems that the EC does not intended to introduce local content clauses in the automotive industry and that Asian companies established in Canada will not have to worry about being included in the restriction agreements entered into with Japanese and Korean manufacturers. Specifically, any vehicle considered "North American" by the Canada-U.S. FTA will very likely also be considered North American for the purposes of importing to Europe.

c) Possible Strategies

To take maximum advantage of the opportunities of Europe 1992, Canadian firms, especially office equipment parts suppliers, should consider the following success factors:

- **Entrepreneurial drive.** The key factor for Canadian firms that have been successful in the EC automotive market has been the entrepreneurial drive to seek out opportunities and make them happen.
- **Proprietary technology.** In a period of severe supplier rationalization in Europe, technological proprietorship and innovation will be one of the few paths of entry for a new supplier; high quality and low price will not be sufficient.
- **Effective promotional material.** Since Canadian firms continue to have a low profile in the EC market, they will have to take specific steps to make EC assemblers aware of their capabilities. This will involve developing comprehensive, targeted documentation and A/V material on the firm, its products, its technologies and its capabilities.
- **Long-term commitment.** In all cases a long-term perspective will be vital. The firm may have to start with very small contracts to gradually build a profile and a reputation with vehicle assemblers.
- **Export options.** A good relationship with Ford and General Motors in North America may facilitate access to these companies' subsidiaries in the European Community, particularly as sharing of components and technologies across continents increases.
- **Representatives.** It will often be very useful to use the Canadian or North American representatives of the EC vehicle producers as an initial point of entry.
- **Joint ventures.** Consideration should be given to establishing a presence in Europe by pursuing the joint venture option. This addresses the need to be geographically close to the assembler and overcomes barriers raised by the rationalization of this sector.
- **Anticipate increased EC competition.** Many European parts firms will be forced to merge to remain competitive. Hence, surviving European players may emerge in a strengthened position to compete in world markets, including the North American market.

7.5 Minerals and Metals

a) Consequences in the EC

The direct consequences of Europe 1992 on the minerals and metals industry is limited: none of the 279 Directives directly concern this industry, except perhaps some environment Directives. The main obstacles to trade in this sector (i.e., government aid and subsidies to companies) are not directly addressed by Europe 1992. The elimination of border controls may have a limited impact.

On the other hand, the rationalization in EC economies has also affected this industry, making European companies more competitive. Efforts have also been undertaken in the EC to rationalize and limit government aid and subsidies granted to companies, including those in the minerals and metals industry.

b) Consequences for Canadian Companies

For Canadian companies in the minerals and metals industry exporting to Europe, the main consequence of Europe 1992 is the growth and investment renewal which is making the EC a much more dynamic market than in the 1980s, at a time when the North American economy is slowing down.

Other aspects, such as custom tariffs, aid and subsidies to Community companies, will only be slightly affected.

The large-scale marketing of processed products will continue to require on-site transformation facilities, and firms already established will be best placed to benefit from Europe 1992.

In the long run, an important consequence of Europe 1992 and of perestroika in the Soviet Union and Eastern Europe could be that Eastern European countries will become important suppliers of minerals in the EC. This could involve co-operation between Eastern European and North American companies.

c) Possible Strategies

Due to their expected assets and investments in the 1980s, Canadian companies are well equipped to face the globalization movement presently under way, of which Europe 1992 is only one element. Their strategies should therefore be only slightly modified by Europe 1992.

The question for individual companies is if strengthening their presence in the EC is necessary to better profit from the positive dynamics created by Europe 1992.

7.6 Forest Products

a) Consequences in the EC

The forests products sector has taken little notice of the removal of border controls or the opening of public markets. It is, however, directly affected by the mutual recognition of standards and by their harmonization at the European level in environment, health (phytosanitary standards), security (standards on fire hazards), and construction codes (Eurocode 5 is the code covering wood structures).

Furthermore, the liberalization and rationalization trends accompanying Europe 1992 are being expressed in this sector via a widespread movement of restructuring and re-investment. Efficiency and competition among European companies have appreciably intensified.

b) Consequences for Canadian Companies

There are many consequences for Canadian companies.

The growth and investment renewal, like the harmonization of standards and certification procedures, have broadened the European market and made it more dynamic and more easily accessed by Canadian firms.

The harmonization of standards and construction codes has aroused fears that some of these are not compatible with Canadian equivalents, which would entail additional costs to Canadian companies and the loss of a competitive edge. These fears have yet to materialize, but the vigilance of Canadian companies and the government should be maintained.

Clearly, the restructuring of companies in this sector, increased efficiency, and the efforts of firms in the Nordic EFTA countries to prepare for Europe 1992, call for Canadian companies to work hard to preserve their competitive edge.

c) Possible Strategies

Europe 1992 has important implications for Canadian firms. In the international environment of the 1990s, a more efficient and internationally competitive industrial base will be critically important for Canadian success in all export markets, including the EC, as will ongoing efforts to ensure an adequate supply.

Canada's principal forest product competitors in the EC, the Nordic countries, are often leaders in technology, product innovation and international marketing and enjoy preferential access to the EC. They have also been particularly active investors, engaging in mergers and acquisitions in all sectors of the EC forest industry.

Competition from non-traditional suppliers is also increasing in a number of product areas.

Clearly, therefore, a priority for Canadian industry will be the continuous modernization and rationalization of the industrial base, as well as the promotion of new and alternative technologies, products and markets. This would involve both the modernization of existing facilities and the construction of new plants.

An investment strategy must be developed. The ongoing restructuring will establish companies' market positions not only in the EC but also in the rest of Europe.

The prospects for the Canadian forest industry in the EC are good. Continued success will depend largely on how the Canadian industry deals with the issues.

7.7 Defence, Aerospace and Transport

a) Consequences in the EC

EC public procurement markets represent approximately C$600 billion annually, or the equivalent of Canada's GDP. Historically, EC Member States have almost exclusively favoured domestic suppliers for public procurement. In the urban and long-distance transportation equipment sector, as well as in the defence sector, national policies have led to industry fragmentation, nationally dominant companies, high costs, and divergent standards and regulations. In the aerospace industry, however, Europeans joined forces in the early 1970s, and co-operation is growing, though manufacturers rather than public procurement authorities are taking these steps.

The opening of public procurement markets to inter-EC competition is one of the major objectives of Europe 1992 and these markets will be among those most affected.

Many companies have anticipated the opening of public procurement markets, and this has led to widespread restructuring and concentration, out of which two or three European leaders are emerging; the other players will have to opt for niche strategies. The railway equipment and material industry is a good example of this, with restructuring gravitating around ASEA-Brown-Boveri on the one hand and GEC-Alsthom on the other. Restructuring or similar arrangements are under way in the air transport and defence sectors.

b) Consequences for Canadian Companies

Generally, the opening of European procurement markets should have positive results for Canadian companies that can operate from a European base. Recent directives maintain a preference to companies that offer at least 50 per cent Community content.

Furthermore, restructuring creates opportunities for Canadian companies that have the means to reinforce their presence in Europe through mergers or acquisitions and by getting a foothold in certain markets. Bombardier's strategy of purchasing Shorts in Ireland and the French railway builder ANF is a good example.

c) Possible Strategies

The Canadian defence industry appears to be most vulnerable to changes occurring in Europe. The restructuring of the European defence industry around a few large manufacturers will make the latter much more competitive both in the European market and in non-EC markets. Several large manufacturers will emerge from this wave of rationalization, enabling them to finance the increasingly high costs of R & D, production, and marketing new products. In addition to having to contend with increased competition, the Canadian industry may face new EC tariff barriers. Faced with these new challenges, the Canadian defence industry will have no choice but to try to extend not only the technological edge that has created its success, but also an emphasis on niche markets (subsystems rather than whole systems). Above all, the industry must maintain its presence in Europe.

7.8 Specialty Chemical Products, New Materials, Pharmaceuticals and Biotechnologies

a) Consequences in the EC

The creation of the Single European Market involves reducing administrative delays for intra-EC trade, standardizing VATs, harmonizing product standards, making product registration and licensing decisions public, strengthening intra-EC intellectual property rights and, to offset greater competition in the Single Market, an increase in legislated protection for employees. The net effect of these changes will likely be a substantial increase in EC economic growth. This growth will create a wide range of business opportunities for the industries examined in this section -- for Canadian as well as for European firms.

The competitive strength of EC firms within the sectors covered by this section varies. The EC has more than its share of the world's largest chemicals and plastics firms. These firms are widely thought to have a technical edge over their North American competitors. They have been particularly aggressive in increasing their production of specialty chemicals and technical plastics, which are usually characterized by higher value added and lower cycle-sensitivity. There is also some strength in advanced industrial materials, partly based on European strength in plastics and partly based on experience in the use of such materials in other industries in which European firms have strength -- in particular, defence, nuclear energy generation, and automobiles. There is also some EC strength in pharmaceuticals and biotechnology, but on balance Europe tends to lag behind North America in this area, largely because of the market fragmentation that Europe 1992 is designed to overcome.

EC firms have been preparing for the Single Market through a large number of mergers, particularly in countries where the industry is relatively weak (such as Spain), and by buying North American firms or divisions or establishing joint ventures with them. This latter strategy secures North American marketing expertise (particularly in pharmaceuticals) or in some cases exploits a perceived technical advantage in North America while evading the increased competition of the Single Market (particularly in plastics).

b) Consequences for Canadian Companies

The capacity of Canadian firms to exploit the opportunities of Europe 1992 is affected by several factors.

The Canada-U.S. FTA will have mixed effects. On the one hand, adjusting to the

FTA means that some firms will have enough on their hands without dealing with Europe 1992. On the other hand, the growth in scale and specialization produced by the FTA means that some firms will be better able to compete in other international markets, including Europe.

Many of the Canadian industries covered by this section are dominated by foreign multinationals that already have divisions in Europe. Beneficial effects of Europe 1992 for Canada involving these firms depend on the capacity of Canadian management to secure world or regional product mandates. Given the scale and technical level of Canadian plants, this is more likely in chemicals than in pharmaceuticals.

c) Possible Strategies

Canadian firms have various methods for exploiting the Single Market. They can invest in production facilities in Europe, establish joint ventures with European firms, or export to Europe either through their own sales organization or through marketing arrangements with European firms. In general, the greater the "presence" of a firm in the EC the better equipped it will be to profit from the Single Market. Firms with production facilities in the EC will normally have better information about market opportunities and will also likely be better informed about, and be able to influence, decisions on product standards.

Firms that neither do business with the EC now nor plan to in the future cannot assume they will be unaffected by Europe 1992. The Single Market is likely to increase the size and competitiveness of firms that exploit it, and these firms are likely to use their additional resources to increase their presence in North America, and in other world markets. Sooner or later, many firms with no economic connection with the EC are likely to confront greater competition because of Europe 1992.

7.9 Industrial Products and Services

a) Consequences in the EC

Europe 1992 will affect industrial products and services largely through the recognition of mutual standards, the opening of public markets, the liberalization of capital movement and of corporate law (which will enable speedier mergers, acquisitions and regroupings), and the establishment of European R & D programs.

Under these measures, European firms (dominated by German and to a lesser degree Italian, French and British firms) enjoy economies of scale and are becoming increasingly productive and innovative.

b) Consequences for Canadian Companies

The base position of Canadian companies in these sectors is relatively weak because many are subsidiaries of foreign firms. As such, their R & D expenditures and technological performance are often inferior to that of their European counterparts; their share of European imports is less than 2 per cent, and the balance of trade with the EC in these sectors is negative. Furthermore, only a few of the Canadian firms operating in this sector are established in Europe.

However, Canadian companies have significant assets at their disposal in sub-sectors such as environment-related equipment, forestry, drilling, mining exploration and some agriculture equipment. These subsectors should benefit from the lowering of non-tariff barriers and a greater opening of public markets as a result of Europe 1992. Furthermore, the sustained growth of EC investment is encouraging.

On the other hand, the European market should become more competitive and more difficult, and European firms will become competitors in Canada and in other foreign markets.

c) Possible Strategies

The best way for Canadian companies to take advantage of Europe 1992 is to reinforce their presence and their level of establishment in Europe. They will thus improve their knowledge of European markets to take advantage of opening and growth; benefit from merger, acquisition or alliance possibilities offered by restructuring; and benefit from the opening of public procurement. The new Directives on public procurement will continue to favour companies that offer a 50 per cent minimum EC content.

7.10 Financial Services

a) Consequences in the EC

The financial services, banking and insurance sector is among those most affected directly and indirectly by Europe 1992. Specifically, it will profit from the liberalization of capital movements, the freedom to sell its services beyond its borders, the freedom to establish in other countries, and most importantly the principle of mutual recognition, by which EC firms will be able to offer their services within the whole of the EC while being regulated solely by their home country. These charges are incorporated in the second banking Directive and in equivalent Directives for the insurance and other financial services sector.

This sector should also register the greatest drops in prices and the strongest gains in productivity as a result of deregulation and the integration of the European market.

Consequently, the EC banking and insurance industry is witnessing, under the momentum of Europe 1992, widespread restructuring and concentration extending beyond the EC. This process is increasing the strength of European international leaders.

b) Consequences for Canadian Financial Institutions

The main consequence for Canadian institutions lies in the strengthening of competition at the international level at a time when deregulation is more constraining for Canadian companies than for their European counterparts, and when Canadians must face particularly high interest rates.

c) Possible Strategies

Canadian companies have not reacted specifically to the advent of Europe 1992, but rather to general market conditions influenced by events such as the FTA and drastic changes in Eurodollar markets, in which they were once very active. Deregulation and internationalization have reduced margins which, together with rising costs, have forced companies to focus on a selection of sophisticated services for which Canadians offer a particular expertise. Banks and their investment dealer affiliates are specializing in capital market products such as mergers and acquisitions, which are in great demand in Europe. Insurance companies are considering promoting abroad some of the experience and technology developed for products like mutual funds management and life insurance policies. Canadian financial institutions are developing a product-by-product approach and have preferred to remain independent rather than to enter into some form of association with competitors.

Canadian institutions see great potential in Europe, but major initiatives need time and must be very carefully planned. Attention is first focused on consolidating the domestic market. The U.S. market also offers attractive opportunities for expansion. Techniques and technologies developed in that market can in turn be exploited in European countries. In the meantime, Europeans are moving very quickly. Leading institutions are occupying key positions, alliances are being sealed and potential partners are playing musical chairs around the best projects. For

Canadian financial institutions, venturing out of the U.K. to the EC frontiers means facing new cultures and unfamiliar markets, but it might also mean major success. Are Canadian companies sufficiently aware that some of their products are very appealing to Europeans? This appeal, coupled with Canadian marketing know-how, should produce success.

7.11 Fisheries Products

a) Consequences in the EC

The fisheries products sector in the EC is directly affected by the acceptance of mutually recognized standards, the setting up of EC phytosanitary standards and the removal of border controls. Indirectly, Europe 1992 is bringing about re-organization of distribution networks and greater efficiency on the part of European firms.

b) Consequences for Canadian Companies

The liberalization of intra-Community trade and of procedures for accessing the European market should have largely positive consequences for Canadian companies that export to or are established in Europe.

With a few exceptions, the increase of European requirements for phytosanitary standards should not affect Canadian companies due to the international recognition that the Canadian system enjoys.

The concentration as a result of mergers, acquisitions and alliances in the EC is a good opportunity for Canadian companies to establish themselves there.

The improved competitiveness of European companies makes them more serious competitors for Canadian firms, although eventually it may make them potential allies. EFTA firms that adapted rapidly to the new European situation by establishing themselves in the EC are now direct competitors for Canadian companies.

c) Possible Strategies

These include three categories:

- **Continued exports.** Companies exporting fish or seafood not available in large quantities in European waters (i.e., crabs, lobsters, etc.) should be able to continue their exports without problems because Europe 1992 will not bring about drastic changes to this market segment.
- **Mergers/acquisitions.** Large companies with access to capital should consider this option to establish a presence in the EC and to guarantee access to the market, to distribution networks and to fisheries products resources throughout Europe. Many larger Canadian companies have already taken this direction.
- **Alliances.** This option is well adapted to small- and medium-sized Canadian companies that enjoy great demand for unprocessed fish products within the EC because of the decline of many species in Europe.

7.12 Professional and Consulting Services

a) Consequences in the EC

For business lawyers and chartered accountants even more than for other sectors, Europe 1992 is but one factor in a more general trend towards globalization and internationalization.

Europe 1992 involves a number of measures aimed at harmonizing accounting standards and providing for freedom of practice and establishment for lawyers and public accountants within the EC. Most of all, however, it involves deregulation of these professions within each EC Member State to strengthen their national positions so they can become more internationalized to face competition from other countries.

In all EC countries, national mergers are taking place at a fast pace, in addition to efforts to become established abroad and to create different types of transnational networks. In both professions, large British, American and to a lesser extent Dutch firms are at centre stage.

In public accounting, the clear winners are the "Big Six," which are experiencing phenomenal success in Europe and have integrated the largest national firms there. The "Big Six" may also play an increasingly important part in the legal profession because deregulation seems to be bringing down some of the barriers that separated the two professions; eventually, large "multidisciplinary" enterprises may be created.

b) Consequences for Canadian Companies

These developments offer new opportunities for Canadian firms because audit, legal and other consulting markets develop rapidly as a result of internationalization and related re-organizing. They also involve risks because large international competitors (American and British firms, the "Big Six") are becoming stronger; globalization will eventually reach Canada, opening all or part of its domestic market to international competition.

c) Possible Strategies

Canadian firms have all the assets required to meet these new challenges: size, work methods and mastery of English as a language of business, which relate them to British or American firms rather than firms in continental Europe, which appear more "small scale." However, they do suffer from two handicaps: the low degree of internationalization of Canadian enterprises (and particularly their current lack of response to Europe 1992) and a certain reluctance, until recently, to risk venturing into international territory.

Despite these handicaps, acquiring an international dimension is now at the heart of the strategies of large Canadian law and public accounting firms.

For business lawyers, this means a reinforced position (via mergers, acquisitions, associations, etc.) at the national level so as to have the means of growing internationally, developing foreign offices, either alone or with Canadian partners (or American partners in the future), and developing specialized niches. Faced with growing international competition, the leaders in the profession have realized the stakes are high.

In the accounting profession, the leaders in the various provinces essentially have two choices: integrate into the networks of the "Big Six" (which international developments seem to point to, particularly in Europe), or opt for a more decentralized strategy, which means having considerable regional representation along with a specific positioning in certain niches. The latter strategy is more adapted to a clientele comprised mainly of small- or medium-sized businesses.

NOTES

1. Department of Finance. *Canada's Economic and Fiscal Performance and Prospects, Chart Book*. (Ottawa, February 1990), page 1.

2. Informetrica Limited. *The Free Trade Agreement: Implications for Canada's National and Provincial Economies.* Volume III, Case IIIA. (Ottawa, July 1988)

3. In this case, the FRG opposed the importation of "Crème de cassis de Dijon" on the basis that, according to German regulations, it did not contain a sufficient degree of alcohol to be considered a liqueur. The Court of Justice of the European Communities, located in Luxembourg, ruled that what is good for the French is also good for Germans (and vice-versa). Since this 1979 decision, the principle of mutual recognition has been confirmed by the Court.

4. Directives are the "laws" of the EC.

5. This motive is confirmed by the surveys of companies undertaken in the various Community countries.

6. Strictly speaking, the Single European Act and therefore Europe 1992 do not apply to the defence sector. However, this sector has been influenced by the Europe 1992 process and is restructuring significantly.

7. "1992: The New European Economy," *European Economy*, No. 35, Commission of the European Countries, Brussels, 1988, p. 17.

8. The margins given in the Cecchini Report are from -4.5 per cent to -7.7 per cent for the fall of consumption prices and from 3.2 per cent to 5.7 per cent for GDP growth.

9. Because of sustained growth in the EC, this phenomenon should only manifest itself as diminishing growth of extra-EC imports.

10. These predictions do not yet take into account the potential impact of the opening up of Eastern Europe, and of German unification in particular.

11. Extension of this accord to include Mexico could reinforce these effects.

12. This is due primarily to the historical relations between Canada and the U.K. (common language, common way of doing business, etc.) and the fact that regulations concerning foreign investment are less restrictive there than in most other European countries. This, however, is changing rapidly as other countries are modifying their regulations.

13. IFO-Institut is a German consulting bureau located in Munich.

14. For more detail on the main explanatory variables of this model, see "The Challenge of the Eastern European Revolution," in *Europe 1994*, BIPE, Cambridge Econometrics, IFO, Prometeia, January 1990.

15. Assuming a more or less optimistic scenario regarding the rhythm of introducing a market economy.

16. The problem arose particularly for banks; American banks in Europe can be universal whereas, strictly speaking, the reverse is not possible for European banks in the United States: American regulations prohibit universal banks.

17. For the time being, the Directive does not abolish existing national laws.

18. The stakes were particularly evident when the telephone exchanges sector was experiencing major restructuring around Alcatel, Siemens and Erikson. AT&T was able to enter into Italtel capital, whereas Northern Telecom was eventually alienated after a fruitless attempt to take over CCCT (the second largest French producer, which ended up being taken over by Erikson).

19. "International" in this context refers to non-European -- American, Japanese, Canadian, etc. -- firms.

20. See the sectoral report on defence, aerospace and transport (to be published in early 1991).

21. Thus, the concept of "highest substantial transformation" was used against exports of electronic equipment from Japan and South East Asia. Consequently, the Japanese and, to a lesser extent, the Koreans started to invest heavily in Europe. A similar process is in the works in the automobile industry; while the controversy over Community content of Japanese automobiles produced in the United Kingdom did not end up translating into regulatory constraints, it resulted in encouraging the Japanese to increase their presence in the Community and to reduce their share of extra-EC purchases.

22. Nevertheless, it is possible to follow this standardization work from Canada through the Standards Council of Canada. Local representatives of Canadian companies will also have some access through their respective national standards bodies, which sit on the CEN/CENELEC Technical Committees.

23. The recent acquisition of Connaught by Mérieux is a case in point.

24. The acquisition of Connaught is a good example of this problem.

25. The wave of mergers and acquisition in law and accounting firms due to recent deregulation is a good example of such a process.

External Affairs and International Trade Canada

Affaires extérieures et Commerce extérieur Canada