

**EUROPE'S ECONOMIC INTEGRATION IN 1992:
IMPLICATIONS FOR THE UNITED STATES**
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Good afternoon! I am pleased and honored to be a participant in a conference dedicated to long-run perspectives on international business strategies--in this case with respect to 1992 in Europe. Too often, I feel, we have allowed ourselves to be swept along by international events rather than thinking ahead to where we would like to be as those events unfold. The advent of the unified European market is one development for which we have ample advance notice. Already important steps have been taken as some of the nearly 300 trade barriers maintained by individual nations are being dismantled. A private sector response is already under way in the form of increased merger and acquisition activity among European firms in anticipation of new market conditions. It would be most imprudent for American businesses to ignore these fundamental market changes, and I am pleased that you have taken the time this afternoon to gather to discuss the implications of this milestone in world trade.

While I count myself among those who believe European economic integration will eventually occur, it is important to point out that the final shape of market unification has yet to be determined. Even when the blueprint for unification being drawn up by the leaders of the European Community (EC) is in place, it is going to take some time before it is fully effective. Consider how long, for example, it took to complete negotiations on the U.S.-Canada Free Trade Agreement. If two countries so close in culture and level of development needed protracted discussions to reach an agreement, it stands to reason that the much more diverse nations of Europe will require a substantial period of adjustment before perfecting economic unification. Moreover, the agenda for 1992 does

not go the full way to economic union. To do so would probably require a common monetary policy and a central bank for the EC, and these measures remain quite controversial. England in particular has consistently voiced opposition to the concept of a European central bank.

Regardless of the exact timetable for Europe, however, we are undoubtedly in a business environment that is rapidly taking on global dimensions. The successful business in the mid- to late 1990s will be the one that has prepared itself to participate in markets that cross national boundaries and encompass a redefined Europe as well as the Pacific, Latin America, and other areas. This preparation entails a reorientation toward broader international competition on the part of companies here, particularly small- to medium-sized firms. It also calls for assistance from policymakers in bringing U.S. national policy into line with the economic realities of our day. This afternoon, I would like to talk about several ways in which we must adapt to the changing situation--both as a nation and in conducting our individual businesses. First, however, I will discuss some of the potential opportunities and obstacles implicit for U.S. business in Europe's progress toward 1992.

Opportunities for U.S. Business in EC Market Integration

As we look toward the emergence of a large integrated market in Europe, numerous possibilities for stimulus to the U.S. economy appear. The most obvious one is the possibility of one large market for U.S. goods and services in place of 12 smaller markets, each with its own peculiarities, that now exist among EC member nations. A second is for increased investment in this country flowing from European corporations, which will grow in size as a result of market unification over there.

Given our marketing experience, the unification of Europe's fragmented national

markets should work to the advantage of U.S. firms. After all, we have more experience than anyone else in selling to a large, unified market--our own. Our industries are geared toward long manufacturing runs that supply products to national retail chains. These companies lend their reputations to the products they buy and also handle national distribution and advertising. This is one factor that has eased foreign firms' penetration of our market in recent years. Here they have to make just one sale of any product--to the purchasers at a major chain--and their volume is assured.

By creating a large-scale distribution network similar to ours, the upsizing of the EC market could relieve one of the problems we have had in selling to Europe. Traditionally, we have not done as well in products for specialized markets as for mass-marketed items. Thus, European firms have built their comparative advantage in speciality items like Leicas and Rolexes while we have sold the world Kodaks and Timexes. There should be room for both types of products in the future EC just as there are in this country, and that would work to our economic advantage.

A second opportunity that we can expect from changes in Europe should be an increase in foreign direct investment in this country. Already a trend toward consolidation of the numerous national industries into pan-European giants has begun in response to the liberalized capital flows that are part of the first phase of 1992-related deregulation. Once these companies accomplish their objectives in Europe--perhaps in the mid-1990s, they can be expected to push into other parts of the world, including the United States. The Southeast in particular should be the target of a good portion of the new wave of foreign direct investment by EC multinationals, just as we have benefited from European, Canadian, and Japanese industrial expansion in the past. This region continues to offer attractive advantages in labor, transportation, and climate.

Despite the strong negative reactions that we often encounter with respect to foreign direct investment, it is not something to be feared. New plants, hotels, and agricultural facilities create jobs for American workers directly and give rise to support services whether their financing comes from foreign or domestic investors. The introduction of additional product sources also enhances competition to the benefit of all U.S. consumers. In addition, foreign-owned facilities operating here offer us insights on alternative methods of production and management. Perhaps most important, the intermingling of industries across international borders further accelerates the development of the global market by giving other countries a direct stake in the growth of the countries hosting their industries. I would also point out to foreign investment critics that the United States still leads the world in total investments outside its borders; it is patently self-serving to oppose other countries that seek to expand in a similar way.

Potential Obstacles to Free Trade

Aside from opportunities provided by enlarged foreign markets and increased investment here on the part of Europe, the changes surrounding 1992 also pose several potential dangers to the globalizing markets and hence for U.S. economic prospects. One is the question of the role reciprocity will play in the final EC accords. The second is the extent to which Europe is able to resist protectionist pressures that will continue to arise, as in the past, from vested interests in EC countries.

The question of reciprocity will probably have particularly important bearing on the internationalization of the financial services industry. Your conference materials include an article from one of the Atlanta Fed's recent Economic Reviews that discusses the dimensions of the reciprocity issue. Basically, the question involves the extent to which Europeans will allow American and other outside firms to participate in their

markets if these non-European countries have regulations that are different from European rules. U.S. laws regarding most industries are fairly liberal in comparison to existing cross-national regulations in Europe. In the case of banking, though, on the basis of a strict interpretation of reciprocity, the current, partially deregulated condition of the U.S. financial services industry would serve to discriminate against American banks. European banks can take an equity position in commercial enterprises, for example, while their American counterparts cannot. Interstate restrictions here would also stand as an impediment in an environment where Europeans permit intercountry branching.

In my opinion, Europeans would probably do better not to go the route of reciprocity. They could decide instead to do business with any country that provides equal regulatory treatment--whatever those regulations might be--to domestic and foreign institutions alike. In that way, the EC could accept American banks and extend the benefits of greater competition to its own residents even if we persist in clinging to regulations that are largely outmoded.

While reciprocity thus remains a potential obstacle, I feel that the U.S. financial services industry has already begun to benefit from discussion raised by this issue. We have been painfully slow to undertake the kinds of banking reforms that would enhance the competitiveness of U.S. banks both at home and in the globalizing market. The prospect of limited access to the European market because of our inability to reciprocate has created a focus for discussion of these shortcomings, as the Economic Review article in your packet demonstrates. I hope this debate will prod Congress toward taking proactive steps to bring this country's depository institutions into the global mainstream.

The danger of renewed protectionism in Europe is another obstacle to maximizing U.S. benefits from market integration there. The impetus for pulling Europe together

came partially from a perception that Europe was being left behind in the growth of economic expansion by the United States and Japan. European leaders reasoned that lowering trade barriers within Europe would eliminate a major drag on growth. They also anticipated economies of scale and scope that could come from a consolidation of small, national industries. Their vision is a good theoretical rebuttal to the shortcomings of protectionist policies among nations, and I hope they will extend it to their non-European trading partners as well.

However, many observers outside Europe fear that Europeans could try to legislate competitors like ourselves and the Japanese out of some of their internal markets to shore up industries they deem vital. We have seen these tensions emerge, for example, in agricultural products; this is a difficult area to resolve, partly because Europeans do not want to become dependent on foreign producers and partly because agricultural lobbies are very strong there--as here. Similarly, the lobbyists for certain traditionally important enterprises may influence their parliaments to press for individual exemptions of their industries when barriers are lowered. Thus, there are numerous pressures within Europe that could lead toward the expression of a "Fortress Europe" mentality.

Should Europe opt for protectionism, the results could be quite dramatic. It could trigger the realignment of the world into distinct trading blocs. What might emerge could be a bloc comprised of the EC members, the northern European countries which have a separate free-trade agreement among themselves, and possibly later, Eastern Europe and the Soviet Union. Africa might lean toward this market constellation. The Western hemisphere and Pacific-rim nations could, by default or design, become a second large bloc. This scenario would be detrimental to all parties by reducing competition, though I think in the long run consumers in the European bloc would fare even worse than we would.

It would be far better if Europe and the rest of us continued to subscribe to the gradual, but successful, reduction of barriers that has been brought about by multilateral negotiations through GATT since the end of World War II. After all, the last world war was brought on in no small measure by the escalation of protectionism in the 1930s. Part of the reason for the formation of the European Economic Community was the hope that future competition could be confined to the marketplace and kept off the battlefield. It would, therefore, be a bitter irony if this idealistic notion were to reverse itself just when the union of Europe reached fruition, and the EC became a force for world divisiveness rather than cooperation.

Policy Implications

This possibility brings us to the policy implications of developments in Europe. I feel both the public and private sectors can take steps to keep this country on course toward realizing the opportunities of the globalizing market. Let's look at the business perspective first. I think one extremely valuable contribution on the part of business leaders would be to make your voices heard among policymakers. As I will discuss in a moment, the budget deficit lies at the root of many of our competitiveness problems, and you should let policymakers know that you want serious action of this front, even if it means increased taxes.

Another area where Congress could perhaps use some encouragement is in completing the task of deregulating the financial services industry. We still do not have nationwide interstate banking or the expanded banking powers our institutions will need to move into the ranks of leading international bankers. Piecemeal steps are being taken by the states, but guidance from the federal government would make a lot more sense.

One more lobbying task for the business community is to counter the persistent

calls for "managed trade" and other forms of protectionism from those who would have us avoid competition. Our competitive problems have much to do with fiscal imbalances, and for that reason protecting our industries from foreign products is a solution that has nothing to do with the problem. Instead, it will create other problems like escalating rounds of retaliation that could undo much of the progress we have made toward enhancing global competition. Moreover, if we wish to encourage Europe and our other trading partners to subscribe to the doctrine of free trade, we have no choice but to do so ourselves.

Finally, our industries, particularly our small- to medium-sized firms, should be gearing up to exploit the marketing advantages they hold when the EC opens its markets. As I mentioned earlier, U.S. companies have experience in dealing with an integrated market that few of their foreign competitors possess. Still, the diversity of cultures and languages in Europe present challenges in marketing that will have to be taken into account. You should begin now, if you have not already, tuning into the buying preferences of countries you plan to target. This, of course, applies not only to Europe but also to other potential markets in the international marketplace. Small- and medium-sized U.S. businesses have a long way to go in catching up to the strong export orientation of their counterparts abroad. Still, the fact that smaller foreign firms have done such a good job of exporting their products suggests that companies here can adapt to the international environment as well.

Turning now to the responsibilities of the public sector, the first place we need to look to improve our international performance is the fiscal deficit. I spoke a moment ago about the sort of xenophobia that frequently surrounds the issue of foreign direct investment here. Another example of irrational anti-foreign sentiment can be found in the rhetoric sometimes applied to our continuing trade deficit. Blaming our trade

problems on some malevolent, aggressive intent on the part of our trading partners is a mistake. Rather, the blame lies for the most part in our own penchant for consuming more than we produce, and this tendency has propelled the accumulation of our government, corporate, and consumer debt. When government spending grew faster than revenues in the early years of this decade, Americans' savings rate was not sufficient to support the resulting deficit. This drove interest rates up and attracted foreigners to our government securities. Foreign demand for dollars to buy U.S. bills and bonds pushed the dollar up on foreign exchange markets. The soaring dollar made our products less competitive on overseas markets, and in this way the federal budget deficit exacerbated our trade deficit.

Of course, borrowing is not bad in and of itself. If we have a need for funds and foreigners are willing to supply those funds, this is a perfectly legitimate arrangement. The problem is that so much of the borrowed money has gone to consumption--particularly by the U.S. government--and not toward investment that might have enhanced our productivity and given us the competitive edge we need to meet the demands of a global market. For that reason, current government spending must allow for the huge chunk of interest owed on past borrowing--the fastest growing item in today's federal budget. Hence, the legacy of past consumption-related spending guarantees that present and numerous future budgets remain in the red unless we take drastic action. Our need to service existing debt diminishes the funds available to make the kinds of investments in private industry we need to stay abreast of marketplace changes. From this perspective, we clearly need to make some serious efforts to attack the federal budget deficit--the single most important cause of our trade imbalances.

Another economic phenomenon that policymakers cannot forget is inflation. I consider intensifying price pressures to be the most immediate danger to our economy

and, potentially, to the nation's competitive position in the years ahead. I think that given the price increases that have already occurred in the first 3 months of this year, we will be looking at a 5 percent inflation rate here by the end of this year. Recently, I have noticed that a growing number of people seem to be comfortable with that rate of increase, but I want to emphasize in the strongest possible terms that such a rate is unacceptable. With 5 percent inflation, prices would double in 14 years. More importantly, we have never been successful in the past in containing prices at the 5 percent level. After reaching that threshold, inflation has had an insidious tendency to accelerate out of control. The inflation of the 1970s and early 1980s was one of the greatest contributors to our indebtedness today, as consumers developed the attitude that they should borrow to buy what they want before prices go up.

So far, current inflationary pressures have not produced dramatic increases in wage demands among workers here as they did in the 1970s. Rest assured, however, that workers inevitably will demand more for their labor if inflation is not checked, and such a development would tend to affect our foreign business dealings negatively. For one thing, inflationary pressures would drive the prices of our products up and their international competitiveness down. For another, to the extent that inflation introduces uncertainty regarding input and output prices, it tends to dampen investment in general. In the midst of such uncertainty, U.S. companies would be less inclined to undertake the kinds of changes they need to make to increase their presence and effectiveness in foreign markets. The Fed is committed to defending the purchasing power of the dollar, as our actions over the past year have demonstrated. However, our job would be a lot easier in an environment of greater fiscal restraint.

Conclusion

In conclusion, we have seen that the prospects of Europe's market unification in

1992 hold numerous opportunities as well as some potential obstacles for U.S. business and the economic expansion of the world. Among the opportunities is the chance to apply our unique marketing expertise in a new and extensive consumer market. All participants in the global market could enjoy the benefits of new sources of competition and the product refinement and lower prices that competition tends to bring. In addition, progress toward European integration should give us the impetus to correct some of our current weaknesses such as the incompleteness of our work on geographic and product deregulation for the financial services industry. It also draws our attention to the need to get our fiscal house in order so that our savings and investment can be turned to more productive ends rather than paying interest for past consumption.

We must hope, however, that the spirit of European cooperation now inspiring so much excitement around the world does not turn into a force for greater protectionism. As business leaders you certainly realize that protectionism is an irrational course that has no place in a world so close to realizing not only the advantages of a unified European market but an integrated global market as well. I urge you to prepare for the new era ahead by taking the positive steps of building competitiveness and opposing any and all impediments to competition.