european community BACKGROUND INFORMATION

EUROPEAN COMMUNITY INFORMATION SERVICE 2100 M Street NW Washington DC 20037 phone (202) 296-5131
New York Office 155 East 44th Street New York N Y 10017 phone (212) MU 2-0458

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BACKGROUND INFORMATION

THE EUROPEAN COMMUNITY AND THE UNITED STATES: 1972

This background note is an updated version of "The Monetary and Commercial Relations Between the Community and the United States: Facts and Figures," published in October 1971 by the Spokeman's Group.

INTRODUCTION

Events during the past year have shown how closely intertwined the world's economies are. Prosperity can be internationally contagious; but inflation, unemployment, and stagnation can likewise be infectious. This places a special responsibility on the world's two major trading powers and trading partners for maintaining both good relations between themselves and an auspicious climate for international economic relations.

The Community recognized this responsibility and played a major role in resolving last year's international monetary crisis. The Community member states were instrumental in achieving the currency realignment in Washington December 18. Following that, the Commission in February negotiated a trade agreement with the United States, which marked an important milestone in relations between the United States and the European Community. It was with the desire to free world commerce further that the Community proposed new global trade negotiations. This initiative opened the way for the declaration made by the Community, Japan, and the United States "to initiate and actively support multilateral and comprehensive negotiations in the framework of GATT [General Agreement on Tariffs and Trade] beginning in 1973 with a view to the expansion and the ever greater liberalization of world trade and improvement in the standard of living of the people of the world."

The following report deals with the various issues which are currently being discussed between the United States and the European Community.

I. GENERAL TRADE DEVELOPMENT

Since the establishment of the European Community in 1958, trade between the two partners has been extremely beneficial for both sides of the Atlantic. The rapidly rising standard of living in the vast market of the European Common Market and the diminishing barriers to commerce in Europe made it an attractive export market, especially for American consumer products and capital goods.

A major additional reason for the spectacular growth of American exports to Europe was the low level of the Community's common external tariff. This was established as an average of the previously existing tariffs of the six member states. In post-Kennedy Round rates, for example, only 13.1 per cent of European Economic Community (EEC) tariffs on industrial goods are over 10 per cent and 2.4 per cent are over 15 per cent, compared to 38.3 per cent of American tariffs over 10 per cent and 23.7 per cent over 15 per cent. The European Community today has the lowest tariff of the major industrial areas:

Average Tariffs on Industrial Products (percentages)

	Raw Materials	Semi-Manuf.	Fin.-Manuf.	All Industrial Products
EC	0.6	6.2	8.7	6.0
United States	3.8	8.3	8.1	7.1
Japan	5.5	9.3	12.0	9.7
United Kingdom	1.2	8.3	10.4	7.6

(Source: "Basic Documentation for the Tariff Study," GATT, 1971)

Since 1958 the Community has been a rapidly growing market for American exports. In 1958 the United States exported $2.8 billion[1] worth of goods to the Community and imported $1.7 billion worth from it. By 1971 American exports had grown to $9.0 billion and imports had risen to $7.7 billion.

The growth of American exports to the Community has been faster than toward many other areas of the world. According to American statistics, from 1960 (the first year of the European Free Trade Association) to 1971, American exports to the EFTA countries grew by 81 per cent. During the same period American exports to all areas rose by 115 per cent; they increased by 143 per cent toward the Community.

The European Community since 1958 has run a constant and large trade deficit with the United States, averaging $1.7 billion annually. (See Table I). In 1971 this deficit amounted to $1.3 billion. The Community was the only major industrialized area with which the United States ran a trade surplus in 1971, the year the US overall trade deficit amounted to $2 billion.

II. AGRICULTURE

American officials have often stated that the Community's agricultural policy is excessively protectionist and harmful to American interests. The figures of American agricultural exports to the Community do not, however, support such charges. All statistics used here are US Department of Agriculture figures.

(1) All dollar figures in this report are at the pre-December 18, 1971, rate of $1 = 0.888~~761~~ 671 grams fine gold.

The European Community is the most important market for American agricultural exports. In 1964, the last full trade year prior to the beginning of the introduction of the common agricultural policy, US agricultural exports amounted to $1.227 billion. By 1971 these had risen to $1.747 billion. During the last seven years American agricultural exports have increased 42 per cent to the Community, while increasing only 26 per cent to the rest of the world. Since its establishment the Community's percentage of total American agricultural exports has remained relatively stable and actually increased in 1971. In 1958 the EEC accounted for 21.3 per cent of the total American agricultural export market, in 1964 21.7 per cent, and in 1971 24.5 per cent.

Community agricultural exports to the United States, on the contrary, are much smaller. In 1958 the Community exported $205 million in farm products to the United States; by 1971 this had risen to nearly $423 million. With imports of $1.747 billion, the Community in 1971 thus had an agricultural trade deficit of $1.324 billion with the United States.

In all industrial countries, agriculture is the "problem child" of development, as governments seek to assure agricultural workers a just income. Farming is an especially important sector of the Community's economy, employing 13 per cent of the active population. In some regions (southern Italy, for example), over 50 per cent of workers are on the land. Agriculture comprises only 4.5 per cent of the American labor force.

All major industrial nations support the income of agricultural workers by one method or another. No industrial country allows free and unhindered trade in agricultural products.

The US government uses the income support method combined with quantitative import restrictions on many agricultural products to protect its farmers. The United States maintains quotas or receives "voluntary" export self-limitations on: wheat, wheat flour, sugar, cotton, peanuts, most milk products, beef, and mutton. Most recently candy and confectionery products have also been subjected to import quotas. The United States operates most of these restrictions via a 1955 waiver to GATT rules, which allows it to limit the importation of most agricultural products. Nearly half of American agricultural production, according to GATT estimates, is shielded by these quantitative restrictions.

The Community's main method of assuring agricultural income is by guaranteed prices and variable levies on a number of important commodities, such as wheat, corn, and milk products. On other products, such as mutton, tobacco, and fruits and vegetables, there are import duties. There are virtually no quantitative restrictions. Today more than 40 per cent of American agricultural exports, including soybeans and soycakes, which last year accounted for nearly $800 million in sales, enter the Community duty-free. Agricultural products comprise 18 per cent of American exports to the Community; 5 per cent of the total exports are subject to the variable levy of the common agricultural policy.

The difficulty of comparing the differing American and Community methods of agricultural protection and income support can best be illustrated by an example. The Community's variable levy on butter in 1969 was higher than 300 per cent. The American duty on butter was 10-15 per cent, but the American market is protected by a quasi-prohibition of butter imports via quotas. The Community, however, imported ten times more butter than the United States.

More important than the method of income support for agricultural workers is the result. An independent study of experts(2) has estimated that the Community supports each agricultural worker by some $860 annually. The corresponding figure for the United States is $1,320 a year.

The problem of European agriculture today is a social problem. Too many workers are farming small inefficient holdings that are incompatible with modern, mechanized agriculture. The average Community farm in 1970 was 12.6 hectares; the average American farm in 1970 was 157.5 hectares. The percentage of the working population on the farm in the Community is three times that of the United States.

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(2) "Comparaison entre le soutien accorde a l'agriculture aux Etats-Unis et dans la Communaute," by Professors G. Vandewalle and W. Meeusen, 1971.

In March 1972 the first directives of the so-called 'Mansholt Plan" were adopted by the EC Council of Ministers. This plan aims at the modernization of Community agriculture, establishing it on a competitive level in world markets and also raising the level of prosperity for European farmers. These first directives call for spending a total of 830 million units of account (UC)[3] in Community funds during the next five years to encourage the formation of larger, economically rationalized farms. Supplementary funds will be spent by the six member governments. To facilitate adjustment of the agricultural population, an annual stipend of 900 UC for a married couple or 600 UC for a single man will be given to farmers aged 55 to 65 who leave the land. This will ease the social problems created by the existing trend toward a dwindling agricultural population in the Community. In 1950, 20 million persons were employed in agriculture; by 1970 farm employment had declined to 10 million; by 1980 it will drop to 5 million. As a part of the total active population, agricultural employment declined from 28 per cent in 1950 to 13 per cent in 1970; it will form an estimated 6 per cent in 1980.

In February 1972 the United States and the Community reached an agreement on several agricultural issues, including grain stockpiling, citrus fruit, and tobacco. On the same occasion both sides concurred to initiate the long-term multilateral negotiations within GATT during 1973, which will cover both industrial and agricultural products. The Community maintained that one means of achieving order in world agriculture is through international commodity agreements. Such agreements are important for developed regions, such as Europe and America, but crucial for the developing countries, which despite efforts at economic diversification, still depend heavily on agricultural exports.

III. NON-TARIFF BARRIERS

The postwar movement of trade liberalization has been most successful in removing the high walls of tariff protectionism on industrial goods erected during the 1920's and 1930's. As tariffs have come down, however, the incidence

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(3) 1 Unit of Account = $1.085~~06~~71.

of non-tariff barriers on trade has taken on greater significance.

The GATT has made an inventory of more than 800 non-tariff measures. American spokesmen complain about "unfair trading practices," implying that the United States is the world's only truly free market. Yet, according to the GATT inventory, all countries are "sinners" in the field of non-tariff barriers. The United States is among the countries against which the most complaints have been leveled. Restrictive trading practices exist on every side; and a major task of the new round of trade negotiations will be to seek a reciprocal dismantling of non-tariff barriers by the United States, the Community, Japan, and other trading countries.

The process of integration within the Common Market has already steadily decreased the number and the magnitude of non-tariff barriers by the Six. "Obstacles to trade" within the Common Market, such as subsidies to shipbuilding, the Italian statistical tax, and technical standards, have been harmonized, reduced, or removed over the past decade to facilitate trade among the Six. At the same time, this process has benefited outside countries.

* The Value Added Tax. Wide misunderstanding exists in the United States concerning the Community's fiscal system of value added tax (VAT), which is sometimes regarded as a non-tariff trade barrier. The VAT has been adopted by the Community as a means of harmonizing the disparate European tax systems, an essential prerequisite for establishing an economic union. Five of the Community countries have adopted the VAT, and Italy will soon follow suit. After establishing the same fiscal system, the next step will be to harmonize the taxation level. Community members currently maintain varying VAT rates.

The VAT, like the sales tax in 46 of the 50 American states, is a so-called indirect tax. The trading rules of GATT permit border adjustments on indirect taxes so that foreign and domestic products compete on an equal footing. On products exported from the state of Pennsylvania, for example, the 6 per cent state sales tax need not be paid. Likewise both locally produced and imported goods are taxed 6 per cent when sold within the state. The VAT is more complicated since the tax is collected on the value added at every step of production, rather than on the retail price. In order to equalize competition under the VAT system, the amount of tax paid is refunded when the good is exported. This is done following the accepted international principle that indirect taxes should be paid where the product is consumed. Inside the Community market, an importer pays a tax on the imported good equal to that which the local manufacturer has already paid. Thus neither the domestic nor the imported product has any tax advantage.

Both the GATT and the Organization for Economic Cooperation and Development (OECD) made extensive inquiries into the trade effects of the VAT and both concluded that the tax was neutral and did not distort competition between exports and imports.

The US Administration is studying the VAT with a view to its possible introduction in the United States.

* American Non-Tariff Barriers. The purpose in the following is not to draw up any exhaustive list of complaints of "unfair American trading practices" but rather to illustrate some of the areas of Community concern:

1) Quantitative Restrictions. From 1963 to the end of 1970, the number of tariff categories covered by American quantitative restrictions rose from 7 to 67. In 1971 the number of these increased again with the introduction of quotas on chocolates and confectionery goods and by the so-called "voluntary self-restraint" on exports to the United States of synthetic and woolen textiles by four Asian countries. Such quantitative restrictions limit the amount of a product which can be imported into a country either via quotas or via voluntary self-limitations by the exporting country. These restrictions are generally much more harmful to trade than tariffs since they set absolute limits on the amount of an item that can be imported. During the same 1963-70 period, the number of items covered by quantitative restrictions

applied by the member states of the Community fell from 76 to 65. In addition, there are 37 restrictions especially applied to Japan in one or another member state, and seven more Japanese products are subject to restrictions in all member states.

Nearly one-fifth of all American industrial imports are covered by quantitative restrictions. This includes a wide range of goods from brooms to petroleum products. The American economist C. Fred Bergsten has estimated non-tariff barriers affect about $100 billion of US consumption annually. The Community has the lowest percentage of industrial imports subject to quantitative restrictions of any major trading entity. Such import restrictions affect 4.3 per cent of industrial imports.

One of the most disturbing new American practices is the so-called "voluntary self-limitation" restrictions, whereby an exporting country agrees to limit exports on a number of important products such as textiles and steel.

2) Valuation Practices. Although its removal was part of the "chemical package" in the Kennedy Round, the "American Selling Price" is still used today, for lack of Congressional action. Under this method of valuation, duties on products such as benzenoid chemicals and their derivatives such as dyes, pesticides, pharmaceuticals, and plastics, are established not according to the value of the imported product but according to the price of the same American produced goods. Other methods of valuation, such as those applied under the "Final List," are extremely complicated and generate incertitude.

3) Government Purchases. The "Buy American Act of 1933" requires the national Government to purchase American-made products unless the American product is either not available or costs 6 per cent (in some areas 12 per cent) more than the foreign product. The US Department of Defense requires that foreign-produced goods must cost 50 per cent less than the American product

and also maintains a long list of products, including food and clothing, where the foreign good may not be purchased at any price. Other countries, including those in the European Community, practice "administrative discretion" in their public purchases. In the United States this is done particularly at the state and local levels.

4) Administrative Obstacles. A wide variety of administrative controls also impede or complicate Community exports to the United States. No foreign-made vessel, for example, can do shipping between two ports along the American coast. The "Marks of Origin" requirement adds to production costs and can result in discrimination against foreign goods. The United States, in addition, does not conform to the accepted international rules on "dumping" and "countervailing duties." Special American rules and the recent proliferation of their use can become a barrier to trade. From July 1, 1970, to June 30, 1971, the American Government started 22 new anti-dumping procedures. During the same period the Community, which complies with the GATT anti-dumping code, started only one new procedure.

5) DISC. The Domestic International Sales Corporation (DISC) Act became law in December 1971. This statute, unique to the United States, allows tax deferrals on 50 per cent of profits to American firms conducting 95 per cent of their business in exports.

In practice, large American companies are establishing "paper subsidiaries" to qualify as DISC's. The 50 per cent "tax deferral" becomes "tax exemption" since it is never taxed as long as the profits are not distributed to stockholders but instead are reinvested for export development.

The Community on October 5, 1971, in a note verbale to the American Government said: "The DISC tax arrangement would involve very considerable exemption from direct taxes on profits and would be such as to encourage exports artificially by reducing prices. This exemption would be incompatible with the commitments of the United States under the General Agreement as regards export subsidies and would involve the risk of serious disturbances in international competition."

IV. AMERICAN INVESTMENT IN EUROPE

American investment in Europe today plays an important role in the total picture of economic relations between the two sides of the Atlantic.

Since 1958 the book value of American direct investment in the Community has grown sixfold, rising from $1.9 billion to $11.7 billion in 1970. Such figures take into account only investments made by American firms directly from the United States and do not include investments by American holding companies located, for example, in Switzerland, Luxembourg, or the Bahamas. In the past decade the Community has been the fastest growth area for American direct investment. In 1958, investment in the Community, largely in petroleum, comprised only 7 per cent of total American investment abroad. By 1970 the Community proportion had grown to 15 per cent of all American investments and three-fifths of it was by then in manufacturing.

The growth of direct American investment, however, is more accurately seen from the figures for the annual expenditure of American capital investment in the Community. Capital expenditure is made up of capital transferred from the United States, capital raised in Europe, and reinvested earnings. Annual capital expenditures in the six Community countries were $420 million in 1958 but are estimated at $3.3 billion for 1972.

This American direct investment has an impact on American exports to Europe and thus on the American-Community balance of trade. Today more and more American products, from computers to detergents, are produced in Europe and are no longer being exported from the United States. In 1968, the last year for which complete figures are available, the sales of American manufacturing subsidiaries located within the Community totaled $14 billion. This was an increase from $12 billion in 1967 and $4.8 billion in 1961. Thus, in 1968, the sales of manufacturing subsidiaries were nearly 2.5 times the value of total American exports to the Community and nearly four times the value of exports of manufactured products. It is impossible to ascertain the exact amount of American exports which are displaced by production in Europe. But it is clear that a large degree of the capital migration from American to Europe was prompted by the conclusion of American companies that it was cheaper to produce in Europe than to export finished products from the United States.

Conversely, direct Community investment in the United States has not been large. The book value of this was $1.4 billion in 1960 and $3.5 billion in 1970. The reason for the low level of investment lies partly in US policy toward foreign investment. As stated in the Commission's 1970 "Memorandum on Industrial Policy," certain features of American legislation hinder direct foreign investment in the United States. In a whole series of industries, such as aviation, electrical, insurance, and manufacturing of alcoholic beverages, no foreign investments are allowed. American antitrust laws, in addition, are applied not only against American subsidiaries of foreign firms but also against the parent company for their activities outside the United States. This restriction has stopped many European firms from investing in the United States. The European Community, on the other hand, only applies its antitrust rules against parent companies for their activities carried out either directly or through subsidiaries within the Community. As is shown by the investment patterns of American firms in Europe, a convenient way of establishing a foothold or extending company operations in a market is the acquisition of existing firms. Such transactions are often attacked in the United States by antitrust officials.

The repatriation of profits from American subsidiaries abroad has recently become a major new source of revenue in the American balance of payments. Remitted income on total US direct investment abroad rose from

$2.95 billion in 1960 to $9.3 billion in 1971. In 1971 American firms in the Community repatriated $1.2 billion, reinvesting the remaining profits in plant expansion in Europe.

V. PREFERENTIAL AGREEMENTS

Since its establishment the European Community has had association treaties with 18 African countries. Other bilateral agreements have been negotiated with a series of Mediterranean countries (Greece, Turkey, Morocco, Spain, Israel, and Malta) and with three East African countries (Kenya, Uganda, and Tanzania). All these agreements are aimed at the establishment of free trade areas or customs unions under which substantially all the trade of the countries concerned will be progressively freed from customs duties, thus fulfilling the rules of GATT. In the case of the original African agreements free trade has now been achieved.

For most of these countries, the association agreement with the Community as a whole was a sequel to historic colonial ties between these countries and certain Community member states. The continuation of the previous trade agreements was an economic necessity as well as a political responsibility for the Community, since many of the nations send more than half of their exports to the European market.

Other countries, which had no special historic links with Community member states, asked for a special relationship with the Community. Three principle reasons led the Community to respond positively:

* In the case of Greece and Turkey, the aim is to enable these countries to become full members when their economies are more developed. In 1971 another step in this direction was taken with Turkey when that country accepted a schedule for establishing a gradual customs union with the Community.

* In the case of the three East African states, it is the Community's declared intention, in the interest of equity, to accept requests for special

relationships from countries placed in a comparable economic situation to the other less developed African countries already associated to the Common Market.

* Association agreements with Spain, Israel, and Malta are intended to safeguard traditional economic and commercial ties.

The major purpose is to assist the economic development of these countries. This can be accomplished both through trade and aid. Most products entering the Community from the associated African states and Madagascar have been duty-free since July 1, 1968. Conversely, most products of the Community enter the associated countries free of duty. Free trade is also envisaged in the Mediterranean association agreements.

The Six have also given Commununity development aid above and beyond the aid programs of the member states. Since 1958, $2.229 billion has been granted to the 18 African states. In recent years, loan aid of $70 million was given to Greece and $175 million to Turkey. After ratification, a new aid protocol will give Turkey additional loans totaling $195 million.

There is no evidence that the trade of any third country has been harmed as a result of these agreements. The United States, on the contrary, has increased its exports toward these countries at a faster rate than the European Community. From 1958-71, US exports to the 18 African countries grew by 158 per cent. During the same period, the Community's exports to them increased by only 97 per cent.

The Mediterranean agreements have been the most contested by the United States. This area, however, is of minor importance in American trade. The total Mediterranean area, excluding Italy and France, accounts for only 6 per cent of US exports and 3 per cent of imports. The Community's agreement with Greece (the oldest, dating from 1962) shows no discriminatory effects against American exports. In 1963-69, the growth of American exports to Greece averaged 10.5 per cent compared to 5.8 per cent for the total Mediterranean area. The aim of the preferential agreements is the economic development of these countries. Both as a richer outlet for exports and because of the "trade creating effect" of any free trade area, the markets of these countries have been, and will continue to be, more attractive to US interests.

Citrus fruit has been one of the products on which the Mediterranean countries have received preferential access to the Community market. In July 1971 the Community in a unilateral gesture to the United States lowered its tariff on oranges for one year from 15 per cent to 8 per cent during the four months of June through September, the period when over 80 per cent of American oranges are exported to the Community.

This February in bilateral negotiations with the United States, the Community agreed to lower its tariff on oranges for two additional years to 5 per cent during the four summer months and from 6 per cent to 4 per cent on grapefruit for two full years.

A final but important element in the Community's Mediterranean policy is the contribution which Western Europe can make in this troubled, and potentially explosive, part of the world. As former Commission President Franco Maria Malfatti said, "It is difficult for us to understand why there is criticism of the Community's policy in the Mediterranean area. It is clear that such agreements are a first step towards an increased European presence in the Mediterranean area, as a factor for equilibrium and peace. I do not believe that anyone can contest the constructive role that can be played in Europe in relieving the strains and pressures felt by the countries bordering the Mediterranean. It is true that such a role cannot find full expression merely in giving some tariff advantage for a product such as citrus fruit. For the moment, the Community does not have other instruments for assistance. The Commission is aware of this lack. We are trying and will continue to try to find better and more efficient means to realize our aims."

VI. JAPANESE-COMMUNITY TRADE RELATIONS

As an explanation for the rapidly rising Japanese exports to the American market, American spokesmen have complained that this is due to European Community protectionism against Japanese products. This is a facile argument not borne out by the facts.

Since the Community's founding in 1958, Japanese-Community trade has been one of the fastest growing in the world. In 1958 the Community exported \$139 million worth of goods to Japan and imported \$117 million worth from Japan. In 1971 the Community imported \$1.542 billion from Japan and exported \$937 million to Japan. In 1971 Japanese exports to the Community rose by 25 per cent over 1970. Japanese exports rose by 44 per cent to France and by 45 per cent to the Netherlands.

Prior to 1968 the Community had a small but regular trade surplus with Japan, but since then it has had an ever-increasing trade deficit. In 1968 the deficit was \$16 million, in 1970 \$245 million, and in 1971 \$605 million.

Historically, the United States has been a more important trader with Japan than has the Community -- both for exports and for imports. In 1955, for example, 22.7 per cent of Japanese exports went to the US market and only 4.0 per cent to the market of the six countries that now form the Community. In 1970, 30.8 per cent of Japanese exports went to the United States and 6.7 per cent to the Community. A similar situation existed for Japanese imports: in 1955 the United States accounted for 31.3 per cent of Japanese imports, while the Common Market "Six" supplied only 3.8 per cent. In 1970, the United States accounted for 29.4 per cent of Japanese imports, while the Community's market share was only 5.9 per cent.

The causes for the different level of Community-Japanese trade as compared to American-Japanese trade are many. Among the most important is the distance between Japan and Europe and the resulting higher transportation costs. The distance between Tokyo and San Francisco, by air, is 8,200 kilometers;

the distance between Tokyo and Rotterdam, also by air, is 12,700 kilometers. The natural barrier of two oceans has limited trade between Asia and Europe. This has been true not only for commerce with Japan but also with other Asian nations.

Also limiting trade between Europe and Japan is the structure of industries and trade. American-Japanese commerce is naturally complementary, with the United States exporting mainly agricultural products and raw materials to Japan and importing Japanese manufactured products and machinery. Japanese and European industries, however, specialize and have their competitive trade advantage in almost the same fields. The two also trade each other almost the same products -- consumer goods, chemicals, classical capital goods, and machinery. In America, for example, the major competition in fields such as small automobiles or consumer electronics comes not from American products but rather from European products. When this same competition is transferred to Europe, the local producer with low or nil transport costs has an obvious and important advantage over the product that has to be transported 12,700 kilometers.

The Japanese thus have concentrated on the closer American market, with a totally unified economy without any barriers to trade, with one language, 200 million consumers, and the highest standard of living in the world.

To take one important example -- automobiles. Japan in 1971 exported about 700,000 vehicles to the United States, with a large proportion being sold in the geographically closer Pacific Coast area. In the American market one of the major competitors for the Japanese car is the small European automobile. In 1971 Japan exported an estimated 120,000 vehicles to the Common Market. Only Italy maintains restrictions on importing Japanese automobiles. The explanation for the difference between Japanese auto exports to Europe and to the United States is clearly found in the stronger competition the Japanese products face in the European market.

It is true that member states of the Community still maintain some quantitative restrictions against Japanese products, as does the United States especially through the so-called "voluntary self-limitations." The Community is now negotiating its first commercial agreement with Japan, which will replace the four treaties of Benelux, France, Germany, and Italy. The aim of this new treaty will be reciprocal reduction by 75 per cent of the quotas in effect on January 1, 1970.

VII. TRADE AND THE MONETARY SITUATION

December 18, 1971, the world's ten leading industrial nations reached agreement on changing the parities of the major currencies. This ended the first phase of the international monetary crisis, which had begun with the floating of the West German mark last May and of the American dollar last August.

The member states of the Community played an important role in the attainment of the December agreement in Washington. This involved their acceptance of a substantial devaluation of the US dollar as well as the revaluation of some European currencies. These heavy revaluations will result in a commercial handicap for the Community member states and a weakening of their international competitive position. This took place at a time when there also existed a less favorable economic situation in certain Community countries. Currency revaluations vis-a-vis the US dollar were made by the following amounts:

Germany	13.58%
Netherlands	11.57%
Belgium-Luxembourg	11.57%
France	8.57%
Italy	7.48%

The Washington agreement, however, was but the first step in the more fundamental reform of the international monetary system. The Community's Monetary Committee in its annual report recently wrote: "The realignment of exchange rates ended the uncertainties which resulted from the floating of currencies and whose negative effects on economic expansion and trade had already begun to be felt in a number of countries. Nevertheless, the application of a mechanism better adapted to the present requirements presupposes that a certain number of other problems will be resolved concerning, in particular, the future system of convertibility, the role of gold, reserve currencies and special drawing rights, the supply of adequate instruments of reserve, the degree of exchange rate flexibility, at the same time as the control of undesirable capital movements."

In discussing the measures taken last August 15, the US Administration has stressed the trade aspects of the American payments deficit. An analysis of the US balance of payments, however, shows clearly that such an explanation provides only a partial answer. The origin of the payments disequilibrium must be found mainly in the continuing large outflows in short- and long-term American capital. A Community representative told a GATT Council last August: "It should be recalled that for the United States the merchandise trade balance is relatively a small item in the balance of payments, particularly when compared with the item covering net receipts from direct investment abroad or the item showing the net outflow of capital to finance these direct investments."

There is no doubt that there has been a decline in the American trade surplus since the Sixties when it averaged $5.4 billion annually; yet in 1970 the United States still had a trade surplus of $2.1 billion. In 1971 the United States ran a trade deficit of over $2 billion, although as noted above it still had a large trade surplus with the Community. This overall trade deficit was partially the result of temporary phenomena, such as extended dock strikes, persistent and high domestic inflation, and low productivity gains. It may also partially result from some slowly moving structural changes in international trade, such as the strong American increases in raw material imports, the change in the United States from a "manufacturing oriented" to a "service oriented" economy, and the impact of multinational corporations. The Community considers, though, that it is not up to the United States' trading partners, through substantial trade deficits, to carry the whole burden of achieving an adjustment in the American balance of payments.

The United States in 1971, according to American statistics, had a deficit in official reserve transactions of $29.8 billion. This was an increase of $20 billion over the $9.8 billion deficit in 1970. Of that payments deficit last year, only $2.9 billion was due to the trade deficit. Trade alone thus does not explain the American balance of payments deficit. The great bulk of the deficit was due to short- and long-term capital outflows. Direct investment capital outflow, for example, maintained its high level during 1971 and totaled more than $4.5 billion. Such outflows in investment capital took place despite American programs to control foreign direct investment. There is thus concern over recent proposals by some American officials to remove these controls at the same time as attempting to turn around the balance of payments.

These deficits in the American official reserve transactions, which were large even in the early Sixties, have been financed by limited American sales of gold but mainly by the accumulation of huge dollar holdings, especially by European central banks or liquid balances in the private sector, Eurodollars. Since August 15, 1971, there has been no dollar convertibility.

VIII. THE ENLARGED COMMUNITY

The prospective entry into the Community of Britain, Denmark, Ireland, and Norway on January 1, 1973, is an event of major significance for the Community and for the world. (See Table IV.)

The United States has steadfastly encouraged the Community's enlargement. In July 1971, following the completion of the substantial part of the negotiations for British entry, President Nixon repeated this support in a letter to the Commission President.

As noted above, the formation and development of the Community has been beneficial for both the political and economic interest of the United States. There is every reason to expect that these benefits will continue and increase in the enlarged Community.

One of the results of Community enlargement for American exports will be a major lowering of industrial tariffs. As shown by the chart on page three, British tariffs on the average are higher than Community tariffs. In four steps ending July 1, 1977, the British tariff will be brought into line with the Community tariff. Preferential treatment presently given to products from Commonwealth countries will also be phased out. The tariffs on some industrial and agricultural products from the four new members will be raised as a result of entry. Under GATT procedures, compensation via other tariff reductions will be given to any country that suffers such tariff increases. Negotiations for such compensations are expected to begin during 1972.

Of perhaps more importance than tariff reductions for American exports is the stimulation of the British economy which entry is expected to bring about. Since 1958 the Community Six have experienced a faster rate of growth than the overall European average. In part this was due to the dynamism of economic integration. An increment in the economic growth of the four is also now expected. Such prosperity will make these countries, especially Britain, a better market for American exports.

The enlargement of the Community will also undoubtedly see a rationalization of American direct investment in Europe. Britain and the Community of Six are both areas of high American investment, and firms will now be able to plan expenditures for one large unified market of nearly 260 million consumers. At the end of 1970 the book value of direct American investment in the enlarged Community was:

Six		$11,695,000,000
Britain		8,015,000,00C
Denmark		361,000,000
Ireland		188,000,000
Norway		269,000,000
	TOTAL	$20,528,000,000

The enlargement of the Community affects not only the four new members but also the remaining members or associate members of the European Free Trade Association. EFTA established an industrial free trade area comprised of Britain, Denmark, Norway, Austria, Finland, Sweden, Switzerland, Iceland, and Portugal. The six latter countries, either because of neutrality or economic underdevelopment, cannot become full members of the Community. At the same time, however, they do not wish to re-erect the tariff walls between themselves and the three departing EFTA members. Future trade relations with the enlarged Community are very important for these six EFTA countries. The following amount of their trade will be with the Community of Ten: Sweden 60 per cent, Austria 50 per cent, Finland 50 per cent, Switzerland 50 per cent, Portugal 45 per cent, and Iceland 40 per cent.

The Community, therefore, has proposed and is now negotiating industrial free trade agreements with the six countries. These will fully conform with the GATT rules, which foresee the establishment of such free trade areas.

In 1970 the United States exported $1.3 billion worth of industrial goods to these six EFTA countries or 3.05 per cent of total American exports.

CONCLUSION

Since the end of World War II, the world has experienced a great liberalization of trade, which has helped to raise the standards of living in all countries. The very existence of the European Economic Community since 1958 has been a stimulus for free trade in Europe and in the world. Neither the Dillon Round nor the Kennedy Round would have been possible without the existence of the Community. The Community will firmly support the new GATT negotiations due to start in 1973 and maintains that these talks should pay particular attention not only to the interests of the industrialized countries but also to those of the developing nations. The Community is committed to freer world trade and rejects any incipient trends toward protectionism or mercantilism.

The foundation of the European Community and its development have been good for Europe; they have likewise been good for America. The Community has been the most important element in the postwar movement to bring the peoples of Western Europe together. It has resulted in peace and prosperity on a continent that has known much bloodshed. For the United States, as this report shows, the Community and the policies it has followed since 1958 have benefited American interests in trade, monetary relations, and investments.

# # #

TABLE I

EC-US TRADE BALANCE (1958-1971)

(in billions of 1971 dollars)

	EXPORTS TO UNITED STATES	IMPORTS FROM UNITED STATES	COMMUNITY DEFICIT IN TRADE WITH UNITED STATES
1958	1.664	2.808	- 1.144
1959	2.371	2.651	- .280
1960	2.242	3.830	- 1.588
1961	2.232	4.054	- 1.822
1962	2.447	4.458	- 2.011
1963	2.563	5.051	- 2.488
1964	2.849	5.438	- 2,589
1965	3.425	5.693	- 2.268
1966	4.098	6.022	- 1.924
1967	4.424	5.898	- 1.474
1968	5.769	6.393	- .624
1969	5.958	7.335	- 1.377
1970	6.634	9.040	- 2.406
1971	7.694	8.976	- 1.282

Source: Statistical Office of the European Communities

TABLE II

A. Book Value of Direct US Investments in EC, 1958-1970

(in billions of 1971 dollars)

	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
GERMANY	.666	.796	1.006	1.182	1.476	1.780	2.082	2.431	3.077	3.486	3.785	4.276	4.579
FRANCE	.546	.640	.741	.860	1.030	1.240	1.446	1.609	1.758	1.904	1.904	2.122	2.588
ITALY	.280	.315	.384	.491	.554	.668	.850	.982	1.148	1.246	1.275	1.422	1.521
NETHERLANDS	.207	.245	.283	.309	.376	.446	.593	.686	.859	.942	1.069	1.227	1.495
BELGIUM/LUX.	.208	.211	.231	.262	.286	.356	.455	.596	.742	.867	.981	1.214	1.510
EC	1.908	2.208	2.644	3.104	3.722	4.490	5.426	6.304	7.584	8.444	9.012	10.255	11.695

B. Book Value of Direct EC Investments in United States, 1960-1969

(in billions of 1971 dollars)

	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
GERMANY	.103	.120	.152	.149	.156	.209	.247	.318	.387	.617	.675
FRANCE	.168	.175	.183	.182	.197	.200	.215	.265	.288	.319	.294
ITALY	.071	.089	.100	.102	.082	.087	.087	.086	.092	.095	.100
NETHERLANDS	.947	1.023	1.082	1.134	1.231	1.304	1.402	1.508	1.750	1.966	2.121
BELGIUM/LUX.	.157	.151	.158	.161	.175	.175	.193	.228	.273	.309	.338
EC	1.446	1.558	1.675	1.728	1.841	1.975	2.144	2.405	2.790	3.306	3.528

Source: Survey of Current Business, US Department of Commerce

TABLE III

Official Reserves at the End of 1971[1]

(in billions of US dollars and Units of Account (UC)* or Special Drawing Rights)

	Total in UC or SDR	Total in New Dollars	Gold Value in New Dollars	Per Cent of Total	SDR Value in New Dollars	Per Cent of Total	IMF Reserve Position Value in New Dollars	Per Cent of Total	Foreign Exchange Value in New Dollars	Per Cent of Total
BELGIUM/LUX.	3.199	3.473	1.676	48.3	0.440	12.7	0.651	18.7	0.706	20.3
GERMANY	17.189	18.662	4.426	23.7	0.493	2.6	1.171	6.3	12.571	67.4
FRANCE (2)	6.905(P)**	7.494**	3.523**	46.9	0.347**	4.6	0.421**	6.0	3.203**	42.6
ITALY (3)	6.251	6.787	3.131	46.1	0.247	3.6	0.378	5.6	3.030	44.6
NETHERLANDS	3.497	3.797	2.073	54.6	0.619	16.3	0.699	18.4	0.406	10.7
EC "6"	37.041	40.213	14.829	36.9	2.146	5.3	3.320	8.3	19.916	49.5
DENMARK	0.664	0.721	0.069	9.6	0.049	6.8	0.057	7.9	0.547	75.9
UNITED KINGDOM	6.062	5.015***	0.778***	15.5	0.553***	11.0	---	---	3.684***	73.5
IRELAND	0.917	0.996	0.017	1.7	0.029	2.9	0.038	3.8	0.911	91.5
NORWAY	1.063	1.154	0.036	3.1	0.060	5.2	0.067	5.8	0.992	86.0
EC "10"	45.757	48.099	15.729	32.7	2.837	5.9	3.482	7.2	26.050	54.2
CANADA	5.249	5.699	0.860	15.1	0.404	7.1	0.361	6.3	4.074	71.5
SWITZERLAND	6.416	6.966	3.158	45.4	---	---	---	---	3.805	54.6
JAPAN	14.147	15.359	0.737	4.8	0.307	2.0	0.532	3.5	13.783	89.7
SWEDEN	1.022	1.110	0.217	19.5	0.079	7.1	0.091	8.2	0.723	65.1
UNITED STATES	12.148	13.190	11.080	84.0	1.190	9.0	0.630	4.8	0.280	2.1

(1) Source: International Monetary Fund (International Financial Statistics)
(2) Bank of France
(3) Bank of Italy
(P) Approximate figure
* 1 UC = $1.08571
** Figure of November 1971
*** Figure of September 1971

TABLE IV (1970)

	SIX	TEN	USA	USSR	JAPAN
Population (in thousands)	189,787	257,242	205,395	244,000	103,540
Gross National Product (in millions of dollars)	485,200	637,400	933,300	288,000	179,180
Imports (percentage of world total) (1)	18.3	25.8	17.2	5.1	8.1
Exports (percentage of world total) (1)	19.2	25.2	19.7	5.8	8.8
Total Production Cereals (Average 1968/70 in thousands of tons)	69,161	91,187	192,966	160,145	1,742
Total Meat Production (1969 in thousands of tons)	11,669	16,216	23,227	9,250	1,136
Milk Products (1969 in thousands of tons)	75,834	98,924	52,707	81,500	4,513
Primary Energy Production (in thousands of tons coal equivalent)	330,828	520,356	2,151,397	1,386,090	71,392
Primary Energy Internal Consumption (in millions of tons coal equivalent)	845.8	1,235.8	2,250.6	---	379.6
Petroleum Products Total Production (in thousands of tons)	391.661	504,208	565,488	---	159,689
Total Gross Production of Electrical Energy (in billions of kilowatt hours)	580,393	909,165	1,738,142	740,926	350,590
Steel Production (in thousands of tons)	109,191	138,943	122,120	116,000	93,322
Motor Vehicles Production (passenger cars & commercial vehicles)	8,029,000	9,670,000	6,550,000	348,000	3,179,000
Rail Transport Passenger/Kms (millions)	120,711	155,748	10,568	266,300	181,921 (2)
Merchant Shipping 1/7/70 (thousands of tons)	28,656	77,317	18,463	14,832	27,004

(1) All figures exclude intra-Community trade between the Six or the Ten. Figures for the United States, USSR, and Japan are percentages of world trade excluding intra-Community trade between the Ten.

(2) 1969