EURECOM

Monthly bulletin of European Community Economic and Financial News

VOLUME 5, NUMBER 6 JUNE 1993

EC POSITIVE ON NAFTA (WITH CAVEATS)

The EC Commission recently issued a largely positive opinion paper on the potential North American Free Trade Agreement (NAFTA) between the US, Canada and Mexico. However, it reserves judgement on NAFTA's compatibility with GATT rules until the agreement is finalized.

For the EC, NAFTA represents a much different (and less ambitious) model of regional integration from any European arrangement: it is based on the hypothesis that free trade is a sufficient basis for economic convergence.

In the short run, NAFTA is not expected to alter significantly the EC's political, trade and investment relations with the US and Canada. In the longer term, EC exports may face some displacement in US and Canadian markets, but a considerable evolution in Mexico's structure of production and trade must take place before this materializes.

By far, the EC's relationship with Mexico — political and economic — will be most changed by NAFTA. First, through NAFTA, Mexico should move gradually toward a standard of economic development closer to its northern neighbors. This means it will achieve more equality in its relationship with the EC. And as NAFTA draws Mexico more closely into the "North American orbit", Mexico's relationship with the EC may gain in importance as a counterweight.

Second, as Mexico's second largest trading partner, the EC has already benefitted from the increased growth and openness in the Mexican economy over the past few years, despite the fact that Mexico takes only 1.14% of total EC exports. Some displacement of EC exports by North American products is expected as tariffs between the US, Canada and Mexico shrink, but the dynamism generated by NAFTA should nonetheless permit further growth in EC-Mexican trade.

Last, the EC is already second largest investor in Mexico. By locking the Mexican economy into a market-oriented regional grouping, NAFTA gives investors considerable security. Hence, the trend toward greater EC investment in Mexico will most likely continue.

Still, while the Commission rates NAFTA's net effect on EC interests as positive, the report also identifies a number of areas where the Community has concerns with the agreement as it stands.

In the areas of **financial services, insurance and investment,** there exists the possibility that NAFTA benefits will be limited to companies which are majority-owned by NAFTA nationals. This is contrary to Community (and EEA) policy toward foreign-owned firms established in the EC, and would constitute unjustified discrimination against EC-owned subsidiaries in North America.

NAFTA rules of origin, at least for cars and textiles, are more restrictive than in Europe (or than in the US-Canada FTA) even if they are not contrary to GATT.

Failure to achieve a multilateral agreement on services in the Uruguay Round could lead to considerable trade diversion in the **services sector** to the detriment of EC service companies, particularly in Mexico.

And EC **farm products,** such as sugar, dairy products and meat, could face higher barriers to the Mexican market under NAFTA. In fact, one NAFTA clause calls for Mexican restrictions on sugar to rise to US levels after six years — and the US sugar market is one of the most protected in the world.

MAASTRICHT MOVES FORWARD

By virtue of the Danish "yes" vote in a second referendum, and because the British House of Commons passed a ratification bill on Maastricht shortly thereafter, the (successful) end of the Maastricht treaty's tortuous ratification process is now in sight.

Based on a compromise struck among EC leaders in Edinburgh last December, which allows Denmark opt-outs in the areas of a single currency, EC defense arrangements, a European citizenship and justice and home affairs (see EURECOM, January 1993), the Danes held a second Maastricht plebiscite on May 18 and reversed last year's rejection, voting 56.8% in favor against 43.2% opposed.

After Denmark's "no" in June 1992 (see

EURECOM, June 1992), the Community fell into a period of crisis and uncertainty from which it is only now emerging. If Denmark had rejected Maastricht for a second time, the treaty, which must be ratified by all 12 member states to take effect, would have been dead.

With Denmark's ratification, the UK is the only member state left to ratify the treaty (although in Germany there are several pending court cases on Maastricht's constitutionality). But after six months of political sumo wrestling, the UK House of Commons finally passed a bill aimed at ratifying Maastricht just two days after the Danish vote. The bill now goes to the non-elected upper house — the House of Lords — where opposition from such notables as Lady Thatcher and Lord Tebbit is expected. Despite such opposition, however, the UK government predicts full ratification before summer's end.

TWO MORE EMS DEVALUATIONS...

Representing the fifth EMS realignment since the September 1992 currency crisis, the EC Monetary Committee agreed on May 13 to devalue the Spanish peseta and Portuguese escudo by 8% and 6.5%, respectively, against the other ERM (Exchange Rate Mechanism) currencies.

Triggered by political uncertainty in the run-up to general elections on June 6 (in which current Socialist Prime Minister Felipe Gonzalez surprisingly won a plurality), high interest rates and a weak economy, Spain took the markets by surprise and unilaterally asked the monetary committee for a devaluation to stabilize the embattled peseta.

In the escudo's case, the devaluation was neither "desirable or necessary" according to Bank of Portugal Governor Miguel Beleza, but because Portugal conducts such a large volume of its trade with Spain, it was once again forced to move in tandem with the peseta (see EURECOM, December 1992).

Unlike previous peseta realignments, however, European currency markets remained calm, indicating that the pressure on the peseta was isolated and that the realignment was successful.

...BUT EMS "FUNDAMENTALLY SOUND"

A newly issued EC Monetary Committee report on last year's EMS crisis concludes that there is nothing fundamentally wrong with the EMS, but if the system is to return to long-term stability, member states must play by the rules and rediscover consensus on economic policy.

The report cites the wide economic divergence between member states as the chief culprit of the crisis, exacerbated by German unification, which led to an "unbalanced mix" between German monetary and fiscal policy (and, consequently, high EC-wide interest rates). Further, as the crisis was building, some member states ignored fundamental economic indicators and failed to take steps to realign their currencies.

In discussing the report with EC finance ministers, EC Commission President Jacques Delors said: "If there were currencies that had to leave the system or change their parities, that was due to the fundamentals of their economies and not to the malfunctioning of the EMS. We have to be clear about that."

To avoid a repetition of last autumn, the report calls for an early warning system of confidential economic indicators to identify well in advance when a country's economy (and currency) is in trouble. The aim is to strengthen consensus among the member states in favor of timely realignments before speculators attack weak ERM currencies. Another key recommendation is that the EMS should adopt internal rules so that any member state can take the initiative to encourage a currency realignment. At present, EMS procedures put the onus on the vulnerable member state to ask for realignment, something which did not work last September.

In defending a currency's parity, however, the report stresses that responsibility for action lies chiefly with the individual member state through instruments like interest rates. "The other member states will determine to what extent and how they can support these efforts through appropriate voluntary actions," said the report.

US ANNOUNCES PROCUREMENT SANCTIONS, EC REACTS IN KIND

After some delay, but true to his word, USTR Mickey Kantor recently announced US trade sanctions worth around $20 million against Community firms in response to the EC's refusal to grant the US full access to the EC telecommunications procurement market in the partial procurement deal reached in April (see EURECOM, May 1993).

As a result, most EC companies will be excluded from bidding on any US federal construction contract worth less than $6.5 million. In addition, they will be barred from goods and/or services contracts with federal agencies under $176,000 and from goods contracts with federally-owned utilities worth less than $450,000. Three EC countries* — Greece, Portugal and Spain — are exempt from the US sanctions.

EC External Trade Commissioner Sir Leon Brittan regretted the US decision. "In view of the progress we made...it is neither justified, wise nor necessary...We are not going to allow this issue to delay or frustrate the progress we are making in the Uruguay Round, nor let it poison the atmosphere, but the US cannot expect us to ignore wholly unjustified action of this kind," he said.

And the EC has not ignored it. On June 8, EC foreign ministers unanimously agreed on "mirror image" countermeasures against US firms, totaling an estimated $15 million a year. Clearly, the retaliatory response was measured and intentionally less onerous than the "modest" US action: the EC is not interested in escalating the matter. It does indicate, however, that the EC will not let US trade retaliation occur without a Community response.

Specifically, EC measures immediately apply to goods supply contracts worth less than 125,000 ecu (1 ecu=$1.20), to works contracts below 5 million ecu and to service contracts under 200,000 ecu.

(*Just as EURECOM was going to print, a USTR press statement suggested that Germany has entered into a bilateral agreement with the US on procurement. Under the alleged deal, Germany would not apply Article 29 of the EC's Utilities Directive, the US would exempt Germany from sanctions imposed on the EC and Germany would not take part in EC counter-sanctions against the US. If confirmed, any such bilateral agreement would be illegal under Community law. Failure by any member state to implement agreed Council directives would render it liable to infringement proceedings.)

QUOTES

*"[European] competitiveness can only be achieved if European companies receive the same flexible operating conditions as their competitors in the US and Japan." **Carlos Ferrer**, president of UNICE, the EC's employers' confederation.*

*"[The Maastricht] convergence criteria are not the major constraint on (EC) growth. The real constraint is that fiscal policy has been overburdened." EC Commissioner **Henning Christophersen.***

*"All member states like to believe they have a 'special relationship' with the US; however, the only possibility to get a really balanced relationship is between the Community as a whole and the US...The question for us on this side of the Atlantic is: do we have the will to...speak with one voice to Washington?" EC Commissioner **Hans van den Broek.***

*"We can guarantee that Europe will remain a good place to do business, for Europeans and non-Europeans alike. That is the reason why it is also important for us that a fair taxation of European companies in the US be assured." EC Commissioner **Christiane Scrivener.***

*"The American people...are unlikely to support a long-term US troop commitment to Europe if they see its purpose as protecting rich, prosperous Europeans against two-bit outlaws like Serbia." Outgoing US Ambassador to the EC **James Dobbins.***

COUNCIL AGREES ON WORKING TIME DIRECTIVE

After two years of toil, the Social Affairs Council has reached a "political agreement" on the Organization of Working Time Directive, which will, among many things, establish a maximum 48-hour working week for all EC workers.

A major part of the Commission's action program to implement the EC's Social Charter (see EURECOM, February 1990), the directive aims to ensure that workers have minimum daily, weekly and annual rest periods and that they do not work excessively long hours at night.

EC Social Affairs Commissioner Padraig Flynn welcomed the Council's decision, saying that it sends "an important signal to the workers of Europe that the Community does care about workers' rights and is not just a 'capitalist club' as some suggest."

The legislation establishes the following principles: a minimum daily rest period of 11 consecutive hours a day; a right to a rest break when the working day is longer than six hours; a minimum rest period of one day a week; a maximum average working week of 48 hours (calculated over four months), including overtime; a right to 4 weeks of annual paid vacation; and a limit on night work to eight hours in a 24-hour period.

Although the Commission originally proposed that the directive cover all employees, the Council decided to make a number of exemptions, including sectors such as transport, ocean fishing, energy production and distribution and activities requiring continuous service or production (e.g. security, firefighting, agriculture and hospital work).

Under the agreement, the directive will enter into force within three years of its final adoption by the Council. However, a member state could postpone the right to a fourth week of annual paid leave for an additional three years. And at the UK's request, a member state will also have the option to allow employees to work more than 48 hours on average provided that such work is voluntary and that safeguards exist to prevent abuse.

Once the Working Time Directive is formally adopted, the UK will challenge its legal basis in the European Court of Justice. According to the UK, the directive should have been classified as a social policy directive, which requires unanimity in the Council to pass, rather than a health and safety issue, which needs only a qualified majority. Eleven of the Twelve voted in favor of the legislation; the UK abstained.

...IN BRIEF

...The EC Court of Justice has ruled that in general, national postal authorities cannot forbid competitors (e.g. private courier services) from offering premium services that are not provided by the state. On the other hand, however, the court said that member states could challenge courier services in national courts if such firms upset the postal system's "economic equilibrium". The court's decision parallels a newly issued Commission proposal to liberalize EC postal services, which calls for maintaining national postal monopolies for basic services, but for opening services such as express mail to competition.

...Software piracy in Europe, which

costs the computer industry some $4.6 billion a year in lost sales, is on the wane according to the Business Software Alliance. In fact, between 1990 and 1991, the percentage of illegal software used in Europe dropped from 76% to 66%. Reasons for the improvement include tougher copyright laws in the EC, increased awareness of the penalties for piracy and a torrent of legal actions against offenders.

...While 73% of EC citizens support the unification of Western Europe, only 41% favor the Maastricht treaty as a way of getting there (versus 24% against and 35% undecided). This is one of many findings in the Spring 1993 Eurobarometer poll.

The survey shows that on average more people are dissatisfied (47%) than satisfied (41%) with the way democracy works in the EC. Similarly, there are more people dissatisfied (55%) than satisfied with the way democracy works in their own country, reflecting the current mood of "throw the bums out" in countries like Italy and France.

Although only three countries — Denmark, Ireland and the Netherlands — supported Maastricht in the poll, over half the survey agrees with plans for a single EC currency by the end of the century. Further, two-thirds of the 13,000 EC citizens polled favor a common foreign policy and 77% support a common defense policy. Relatedly, 55% of European citizens are in favor of EC intervention in ex-Yugoslavia to restore peace.

...Reflecting the severity of the EC's economic downturn, Community unemployment ticked up to 10.4% in April from 10.3% in March and from 9.4% in April last year. And compared with last April, unemployment is up in every member state. Above the EC average were Spain (20.7%), Ireland (18.4%), the UK (11.4%) and France (10.6%).

EURECOM Monthly bulletin of European Community Economic and Financial News

If you would like additional information on any article in this issue, please write or telephone Christopher Matthews or Kerstin Erickson at (212) 371-3804.

Please send a regular free copy of EURECOM to:

Name ______

Position ______

Organization ______

Address ______

Special Interests ______

EURECOM is published by Barbara Noël, Director of Press & Public Affairs, the Commission of the European Communities, 3 Dag Hammarskjold Plaza, 305 East 47th Street, New York, NY 10017. It is edited by Christopher Matthews. The contents of EURECOM do not necessarily reflect the views of the European Communities' institutions or of the member states. Any article may be reproduced without express permission. However, acknowledgement of the source and a copy of any material published would be appreciated.

Printed on Recycled Paper.

EURECOM

Commission of the European Communities
3 Dag Hammarskjold Plaza, 305 East 47th St., New York, NY 10017
Telephone (212) 371-3804