The EEC after 1992:
Implications for Latin American Business

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One cannot dispute the anticipation that has surrounded the definitive movement in Europe to complete its internal market by 1992. And yet, to many outsiders, indeed, even to many insiders, the notion of European integration remains a mystery. Most Latin American firms seem alarmingly unaware of the 1992 issue and its implications.

As informed players in the growing global economy cushion themselves against the uncertain business climate in Europe, many Latin American firms, mostly the smaller and medium-sized ones, are oblivious to available strategies for survival and growth in this new environment. As one business consultant put it, "it's the little guy who is going to get killed, and he most likely won't have the slightest idea what happened." In an effort to remedy this situation, the purpose of this report is to highlight the key issues that businesses must consider in order to stay competitive in the newly evolving Euromarket.

The philosophy of 1992 is viewed by most as a mandate for deregulation, or lessening of formal government standards. It is a complex legislative initiative conceived by the institutions of the twelve member European Economic Community (EEC) to address roughly 300 areas of common concern, referred to as directives. This ambitious effort seeks to remove remaining barriers to the free flow of goods, services, financial capital and labor among member states. Some call it a Thatcherite/Reagan recipe for free market magic. Others would argue, however, that under the guise of deregulation, many formerly unregulated areas at the national level will be subjected to strict supervision by the newly empowered EEC, thus creating a rebureaucratization and nouveau regulation where none, or very little, existed before.

Determining how the restructured resources of Europe will be divided among member and non-member states' firms carries with it seeds of protectionism and other contentious trade issues. A senior U.S. diplomat, Michael Calingert, points to one possible root of the tensions:

> ...the program to complete the internal market was developed essentially as an internal EEC matter. The institutions, interest groups, and other political, economic, and social forces within the community debated the issues and problems, and their solutions, with little regard for their international aspects and implications.

While this debate rages on, a wave of economic restructuring such as mergers, harmonization of tariffs and customs duties, and standardization of industry has swept across the borders of EEC countries. If conducted in an open way, the potential to enhance both European and world economic prospects is great. But the general EEC posture toward non-EEC participation is uninviting. A leading Italian industrialist says, "the single market must first offer an advantage to European companies. This is a message we must insist on without hesitation." A French enterprise remarks that the benefits "should be reserved first and foremost to European firms."

Responding indirectly to these remarks is M. Peter McPherson, U.S. deputy treasury secretary. He states:

> While we are sensitive to the political pressure that will arise from internal liberalization, we would find unacceptable any measures that would limit market access for third countries and discriminate against subsidiaries of foreign companies already established or that wish to establish in the community.

To rebuff the American admonition, the European Community's Trade Minister Willy LeClerc commented on the EEC by saying, "When you're the world's biggest exporter, you don't turn protectionist. That would be shooting yourself in the foot." And in fact, the EEC does wear big shoes. Last year, they exported more than $400 billion worth of goods, and their imports totaled just under that mark. This is roughly equal to the U.S. level and more than three times that of Japan.

In short, the creation of an integrated market of 320 million consumers is a force to be taken seriously. Against this backdrop, the themes presented in this report will focus on: Economic viability of the EEC, contentious trade-related issues, opportunities and challenges for Latin American businesses, and strategies for successful positioning.

I. ECONOMIC VIABILITY: Realignment of sectoral priorities and restructuring of the economy to make fuller use of the productive potential of the EEC.

A) Potential Outcomes: What will the completion of the internal market mean for the EEC in real terms? (estimates)

- An increase in GDP of 7%.
- A 6% reduction in prices.
- Creation of 5 million jobs.
- An increase in exports of 10%.
- With the removal of barriers, companies can implement cost-saving procedures and begin to approach Europe as a mass market.
- According to analysts, a unified market could save the economies of member states some $200 billion.

B) Harmonization Process: Will the economic impact have far-reaching effects?

- Industrial restructuring and standardization may cause tremendous short-term expenses for retooling, but the resultant longer-term cost reduction will improve the price-cost margin to the benefit of the consumer.
- Companies' intensified competition will lead to a weeding out of the weak, with further savings reaching the consumer.
- Lower prices will result in increased demand and eventual increased production.
- Cross-border mergers will be dominated by the financially more sophisticated firms.

C) Enforcement Mechanism: Will the costs associated with implementing EEC policy be prohibitively expensive?

-Border controls.
-Restrictions on the recognition of professional qualifications.
-Value added and excise taxes.
-Legal regimes.
-Restrictions on movement of capital.
-Provision of services.
-Regulations and technical standards.
-Public procurement markets.

II. CONTENTIOUS ISSUES: The need to negotiate and reach common policy is paramount for fruitful international trade relations between EEC and outside markets.

A) "Reciprocity": To what extent will reciprocity (i.e. the EEC should not permit non-member firms to enjoy the benefits of an integrated market unless EEC firms enjoy similar treatment in non-member's country) result in discrimination and protectionism?

- John G. Heimann, chairman of the executive committee of Merrill Lynch Europe has said, "The commission [of the EEC] has made no secret of its intentions to use bargaining power of Europe's new internal market to make sure that the countries outside the EEC give Europeans as good as they get, and it is safe to assume that it will not be shy in applying reciprocity provisions. Reciprocity is a missile aimed at Tokyo that will land in New York and explode in [the Western hemisphere]."
- To date, reciprocity provisions have been incorporated into proposed directives on banking, investment services, and public procurement.
- Extreme example: A Latin American bank might not be able to obtain a license to operate in all 12 community nations because European banks might not have the reciprocal right.
- The United States considers reciprocity to be inconsistent with the principles of national treatment and non-discrimination in financial services and could result in discrimination against U.S. firms whether entering or already operating in Europe.
- National treatment is defined as according foreign investors the right to establish and operate an enterprise on terms which are no less favorable than those available to domestic investors in like circumstances.

B) Merger Control: Who will gain the most significant advantage through mergers?

- Will granting the EEC commission the power to approve or disapprove large-scale mergers with a potential "community" dimension have a major impact on mergers between Latin American multinationals and European firms, or between Latin American firms that have European operations?
- How much would this antitrust regulation lock out Latin American interests from key European sectors?
- For 1988, by August, there were already $20 billion in merger deals in Europe. The number of mergers involving community-based companies jumped from 117 in the fiscal year ending May 31, 1983 to 303 in the end of 1987 fiscal year. For the year ending last May 31, the total soared by nearly 50% from the previous year to 450.

C) Local Content: To what extent will cost of local content be borne by consumers?

- The EEC Commission has in some cases applied local-content requirements for foreign-owned companies to purchase locally a minimum percentage of production inputs for goods sold in that country. These directives respond mostly to the Japanese companies' efforts to circumvent antidumping regulations through setting up of "screwdriver" plants for the assembly of components directly imported from Japan.
- Japan has argued that this is a form of protectionism - and that by virtue of having paid duty on all import components, they satisfied the local content

requirement - at the expense to consumers who see higher prices of Japanese goods in Britain.

- Other foreign investors complain of losing competitive advantage in the host country and in potential export markets.

D) Industrial Standards: Will the new EEC-wide standards and certificate procedure pose greater difficulties for marketing Latin American products than existed before?

- Example from previous (and current) system: a television manufacturer has to make seven types of televison sets to meet member country standards, which incurs tremendous costs in engineering and time.
- The push to "Eurotize" the essential health, safety, and environmental requirements is laudable, as long as these requirements do not hinder market access for Latin American exports. Again, cloaking protectionism with standardization is a common concern.

E) Service Industries: This sector is a "futuristic" concern for Latin American economies which hopefully will want to expand into the sector. It is of immediate relevance to the U.S., with Canada in an intermediary position. Because these are not traded goods covered by GATT rules, the "reciprocity" test may be used by the EEC to limit competitiveness of Latin American service suppliers.

- The EEC is currently preparing some 60 directives affecting commerce in a range of specific service sectors. These include: transportation, banking, securities, insurance, mortage credit, engineering, mobile telephones, information services, medical services, and broadcasting.

F) Government Procurement: What are the chances of Latin American suppliers (especially in the areas of telecommunications, water, energy, and transport services) in gaining access to long sought after markets traditionally reserved for nationals?

- Will the new proposed directives designed to eliminate internal barriers between member states make Latin American bids on opportunities in public procurement more eligible?
- U.S. view: The EEC's efforts to liberalize its government procurement programs have not gone far enough. In the past, contracts went to domestic companies on a no-bid basis, so it's going to be hard for an Italian company, not to mention a Latin American one, to win a contract with West Germany's state-owned telephone company.

G) Veterinary and Phytosanitary Measures: an issue typically relevant to the U.S. yet still of significance for Latin Americans. Will the directives regarding phytosanitary and animal health standards conform with the provisions and spirit of the Agreement on Technical Barriers to Trade?

- Those directives not based on science are likely to be regarded as unnecessary barriers to trade.
- Example: The EEC, citing health reasons, has banned U.S. imports of meat treated with growth hormones. Washington challenged the EEC to

scientifically prove their claim; otherwise, the ban would be labeled protectionist and surely send the trade partners to future clashes.

H) Social Issues: How will this impede corporate decision-making and affect cost implications?

- How much worker participation in company management would be required of firms doing business in the EEC?
- How will the proposed measures governing working conditions, labor relations, health and safety standards, social welfare systems, immigration issues and industrial relations systems be incorporated into non-EEC firms' stategies?

A brief glance at the previous issues reveals the complexity and delicate nature of the EEC's integration package. It forces one to think geometrically, not just in a linear fashion. Moving into the sections outlining opportunities, challenges, and strategies, it is hoped that having had a view of the bigger picture will provide a point of reference from which to contemplate the following suggestions.

III. OPPORTUNITIES AND CHALLENGES: In theory, Latin American business faces a barrier-free single market of 320 million consumers, instead of twelve separate ones. In reality, the EEC goal of the internal market is to enhance the competitive positive of <u>EEC</u> firms, not only inside the community, but also in other markets, including Latin America.

A) The Latin American Stake: To what extent will the increase in demand and consumption vis-a-vis 1992 be absorbed by imported rather than EEC goods?

- The EEC currently accounts for approximately 28% of the exports from the five largest Latin American economies (Argentina, Brazil, Chile, Colombia, Venezuela). Exports in 1987 totaled over $15 billion, but the proportion of Latin American exports has been shrinking steadily since the mid- 1980s while the U.S. portion has grown.
- In contrast, Latin American imports from the EEC have risen and now represent approximately 25% of all imports to the region. In the most extreme case, EEC imports in 1987 represented one third of all Argentinian purchases abroad. Imports from the EEC totaled $11 billion over all, of which $8.3 billion went to Argentina, Brazil and Venezuela.

B) Implications of EEC integration for Latin American businesses: Who are the most likely winners in this 1992 process?

- <u>Well established multinationals (MNCs)</u> that have already positioned themselves strongly in the EEC. Many MNCs have built up a spread of operations and networks in European markets equaled by few, if any, of their local or Japanese rivals. For example, IBM Europe makes in Europe 90% of what they sell there. The Western European assets of American manufacturing totaled 185.5 billion in 1986. Their sales of 235.2 billion were almost four times the value of direct U.S. exports to Europe. Their European subsidiaries employ almost 2 million people, and many do development work and procure locally most of their components.
- <u>Exporters</u> will have greater opportunities arising from the expected economic growth. Greater competition from within the EEC will be a factor, however.
- <u>Investors</u> that have followed a policy of seeking to integrate into the local scene by:
  1) maintaining minimal non-national staff

2) participating in local cultural and charitable activities
3) downplaying Latin American origins

The EEC's stance on national treatment, reciprocity, and rule of origin, that is, the country in which the "last" substantial transformation of the product takes place will determine the fate of outside investors. That is why it is imperative to become an insider.

C) Caveats for Exporters and Investors: What should Latin American firms look out for in this new system?

- Participation in standards setting will be limited largely to Latin American subsidiaries that are classified as EEC firms.
- Latin American testing of products might not be accepted by the EEC standards.
- Devoting efforts to a Europe-wide standard potentially reduces resources available for developing other international standards.
- Will final EEC standards and regulations be written in such a manner designed to impede market access?
- The problem of meshing management styles and cultures across borders... the biggest challenge will be for companies to effect "organizational change," that is, to get managers and staff working closely together across Europe and the United States.

IV. STRATEGIES FOR AN ACTIVE COMPANY APPROACH: Each firm's individual case requires a specific strategy, but most of the following questions and themes should be considered.

A)Review and develop strategies:[1]

- **Management**/internal management structure/links to the global organization
- **Production**/"make or buy"?
- **Purchasing**/new supplier configurations
- **Marketing**/Pan-European brands/after-sales service
- **Distribution**/new transport delivery systems
- **Research and Development**/"Europeanness" emphasized?/ collaborative arrangements in R&D
- **Finance**/competition in financial servies/changing corporate tax rates/harmonization of VAT and excise duties
- **Capital**/size and location of plants
- **Cooperation**/joint ventures/cross-border activities
- **Staff**/recruitment and development

B) Basic U.S. Business Plan: Michael Calingert outlines these main topics.

- **Gather information** through all available resources.
  1) Offices in Brussels
  2) Business contacts
  3) 1992 information services at U.S. Dept. of Commmerce.
  4) Financial Times of London.
  5) EEC European Report
  6) Business Guide to EEC Initiatives
  7) Consulting firms in Latin America, U.S. and Europe

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[1] A supplemented UK Department of Trade and Industry checklist, noted in "Euro-pessimism, Euro-phoria, or Euro-realism?--What American Corporations must do now about Europe 1992!" by Daniel A. Sharp and Jan V. Dauman. [1]

8) Latin American Trade and Business Associations
9) Organization of American States
10) InterAmerican Development Bank, World Bank, IMF

- **Seek to influence** the decision-making process in the EEC.
  *Must be resourceful and aggressive to get an "in" within the proper circles.
- **Seek help** from Latin American government agencies that should be working to ensure equal treatment for Latin American firms in a highly competitive market.
- **Have the right attitude** that opportunities await those who position themselves creatively and innovatively. Remember, in the short and medium term (2-5 years) of the 1992 process, markets can be expected to remain fairly fragmented. Why?
  1) Customer confusion
  2) Existing customer/client relationships
  3) Continuing differences in product standards
  4) Familiarity of local firms with national rules
  5) National preference
  6) Cost of switching over to new system
  7) Local firm's knowledge of language/customs

C) New Mentality: Latin America must follow a new set of rules to not lag behind the rest of the world and maintain a leadership position.

- Must realize that Latin America is operating in a world economy and begin designing products to meet the needs of a global market.
- Latin American business people must educate themselves about other cultures first, <u>then</u> focus on manufacturing.
- Latin American education can be improved through the establishment of higher standards set by business.

D) Preparing for Europe 1992: Four industry leaders agreed on the following.

- All the preceeding issues need to be discussed in the boardroom.
- Planning and research are musts.
- Board members and managers need to know the European Market, not just the language, but its culture and style.
- Select board members with a pan-European level of attitudes.

FINAL THOUGHTS: It is fundamental to proper positioning and strategy to make a continued effort to understand the motives and rationale of the 1992 program from the European perspective. Even though the integrated market promises to create a more open, less discriminatory European standard, human foibles and self-interest can undermine the most laudable intentions. The average European businessperson just might be thinking....

- Outsiders increase competition and risks. Shouldn't they be controlled by EEC policy?

- All new groups need protection at first against those that are more internationally or globally oriented.

- The EEC is doing all the work; outsiders should have to "pay" and not get a "free ride."

- We must protect ourselves against aggressive Asian societies prone to creative marketing (predatory and dumping).

There is only one absolute in contemplating this exciting new business atmosphere. Namely, inaction leads to a deteriorating bottom line. Small- and medium-sized businesses need to seize the opportunties. To not reach for them could be costly, at home and abroad. The best way to start is to start.