CASE 2.1
THE UNITED STATES OF AMERICA VS. THE UNITED STATES OF EUROPE

Instructor Notes

1 (a). Discuss the obstacles and opportunities presented by the EU market.

Potential problems for American exporters include a lack of access to the EU's standard-setting process, content rules in the broadcasting directive, the reciprocity clause, quantitative restrictions, local content requirements, and rules of origin.

Some of the EU's new laws are discriminatory and against U.S. interests. For example, the broadcasting directive places a quota on U.S. programming on EU television. Laws prohibiting some food processing chemicals bar some U.S. products. EU government procurement may prefer products of EU-origin. Also the EU wants "reciprocity" in areas such as service industries, testing, and government procurement. Local content rules may encourage European buyers to buy EU goods, instead of U.S. goods, to meet local content requirements. Furthermore, the EU wants to restrict the import of foreign automobiles.

In terms of competition, American and Japanese firms can expect their European competitors to become stronger and more competitive. European firms are likely to become more aggressive because they no longer operate in a protected home market.

While many U.S. marketers have expressed concern, American firms should generally benefit from this internal market. The EU provides marketing opportunities as fragmented markets are being transformed into a unified market with a free flow of goods, people, products, and money across borders.

The New Europe, as a market, should become even more attractive due to an agreement of the 27-nation EU and the European Free Trade Association to form the European Economic Area. The European Economic Area is the world's largest market as well as most lucrative consumer market because the 19 member nations account for more than 40 percent of world trade. The economic cooperation provides the impetus for long-term European economic growth. A more prosperous market means opportunities for all marketers, and more demand for U.S. products should follow.

Another reason why the New Europe is an attractive market in which to sell has to do with uniform rules. Due to uniform procedures and standards, it is reasonable to expect lower costs and fewer difficulties as better economies of scale are achieved. Some of the specific benefits are as follows:

a) Protection of intellectual property should be less costly as one patent will apply all over Europe. Since proposed directives call for the acceptance of applications for trademarks to be administered from one central office in the EU, American firms will not have to apply to 27 different governments to receive trademark rights.

b) The EU's intention to unify warning labels on most consumer products should make it easier for both insiders and outsiders to sell across borders. Owing to language and culture, however, labels must remain in the language of the market.

c) The cost of documentation and cross-border shipping should significantly drop due to the unification of transport documentation. Previously, member countries had their own forms (as many as 20 for each country).

d) Transportation will become less expensive and quicker. According to the proposed directives on road haulage, trucking firms do not have to stop for border checks. Also trucks entering one EU country from another are no longer prohibited from making more than one stop in that EU country of entry. A 50-percent decline in distribution costs is possible.

e) There is no longer an internal trade barrier of differing product standards, and manufacturers no longer have to make 27 modifications of one product so as to meet the product standards of the individual countries. U.S exporters of forklifts, machinery, trucks, and construction products can sell a product that has met the "essential requirements" without having to make expensive product modifications. Previously, some smaller U.S. exporters were unable to make the 15 modifications of one product.

f) Because of a proposed directive allowing cross-border transmission of television signals, advertising will become more efficient.

Although the EU is undeniably a very important market, the importance should be viewed in proper perspective. There are many other markets which are also very attractive and where there may be less intense competition. One should also keep in mind that there are more than a billion Chinese who have not yet owned a car. So are more than one billion consumers in India. Asia is twice the size of Europe economically, and Asia's population growth is projected to be twice as big as the EU's.

1 (b). How should Japanese and American firms adjust their marketing strategies to meet the challenges?

Although the EU has denied that there is any intent to create an economic "Fortress Europe," Japanese and American firms need to adjust their marketing strategies to meet the challenges. They must regard the EU as a single market--not 27 separate and fragmented markets. They have to reexamine their marketing strategies. For example, Sara Lee has adopted the Euro-branding strategy by putting several languages on a single package.

The acquisition strategy is the fastest way to enter Europe, but it is going to be expensive because non-EU firms probably have the same interest in attractive target companies. A joint venture with a European partner provides an ally while being less costly than acquisition. Starting a wholly owned European company is a risky strategy. If it is not necessary to have a complete corporate presence in Europe, a marketer may want to consider using either direct marketing or European salespeople/representatives.

American firms have pursued a number of strategies. Whirlpool Corp. has entered into a $2 billion joint venture. International Paper Co. made a bid for a French paper maker. Shearson Lehman Hutton Inc. has expanded its investment banking offices in Italy and Spain. General Electric Co. has formed joint ventures in the United Kingdom, acquired France's largest medical equipment maker, and is building a $1.7 billion plastics factory in Spain.

It should be kept in mind that a unified Europe does not really present any more problems than a fragmented Europe. Trade barriers created by individual countries are similar to those created by the EU on a grander scale. Strategies to overcome a country's trade barriers are generally applicable to the EU's barriers as well. In either case, the key is to attempt to become an insider.

2. Discuss the benefits and difficulties involved as the EU absorbs several new members.

See "The Euro: How Damaging a Hit?" *Business Week*, 29 September 2003, 63; and "Kohler Calls for New European Union Members to Strengthen Policies Before Adopting Euro," *IMF Survey*, 16 February 2004, 33-34.

The new 27-nation European Union is an attractive market due to its sheer size. There are additional benefits due to the commitment to the adoption of the euro as their national currency by the ten accession countries. The euro, as a common currency, lowers transaction costs and eliminates market risks, thus boosting economic development through more trade and financial flows.

The new members will also bring some problems and challenges. The disparity between the old and new members in terms of economic conditions will be a big challenge. Many of these new members will also have to adjust to the new market economies. In addition, these countries are not as politically stable.

It should be noted that the EU members often disagree. As in the case of the euro, the United Kingdom and Denmark have permanent opt-out clauses, while Swedish voters rejected the euro in 2003. While Germany and France have championed the euro, they themselves flout some of the rules. Both have defied the requirement that euro zone members must keep their budget deficits below 3 percent of GDP.

The Maastricht Treaty sets out the legal principles for Europe's Economic and Monetary Union and describes four conditions that must be met before countries can adopt the euro: (1) annual average inflation rate that does not exceed that of the three best performing member states by more than 1 1/2 percentage points, (2) annual average nominal interest rate on the 10-year benchmark government bond that is no more than 2 percentage points above the corresponding average in the same three countries, (3) a fiscal deficit below 3 percent of GDP and public debt less than 60 percent of GDP; and (4) trading of the country's currency against the euro without severe tensions with "the normal fluctuation margins" of the Exchange Rate mechanism (ERM2) for at least two years.

3. Assess the likelihood that the EU will be able to establish a political union.

The EU's ambitious plans are to form a political union similar to the United States. The formation, of course, requires members to merge their diverse foreign, economic, and monetary policies. It is not going to be easy because nations, as a rule, do not want to give up their independence and sovereignty. Norway, for example, rejected membership in the EU in a bitter national referendum in the early 1970s, and the country decided again in 1994 not to join the EU. In comparison, Estonians voted overwhelmingly to join the EU.

In spite of the enormous progress made, there are still many problems. Governments have not agreed on how to ensure free movement of people. The United Kingdom, concerned about influx of drugs, criminals, weapons, and terrorists, has shown unwillingness to give up its entry checks. Britain and Sweden do not want to give up control of economic and social policies.

Although the treaty on monetary and political union was supported by all Danish newspapers and most labor unions and employers' associations, 50.7 percent of the Danish voters narrowly rejected the treaty. Danes' longtime fear of being overwhelmed by stronger neighbors who would dilute Danish sovereignty appeared to be the main reason for the rejection of the referendum. The vote in effect prevented the treaty from going into effect because all members must ratify it. In the case of France, French voters approved the treaty in 1992 by a very slim margin.

It is reasonable to expect that further progress will be made in the EU's establishment of a political union. But it is also likely that progress will be painfully slow and that a successful union is not going to happen anytime soon.

4. Why is it that organized labor in the United States opposes NAFTA and further expansion when it never objected to the U.S.-Canada Free Trade Agreement which preceded NAFTA?

Because the United States and Canada are both developed nations which have a great deal in common, the perception of the public is that both countries should benefit from the agreement or at least will not be harmed by it. Also the pattern of trade protection in both countries is similar. According to the Fact Sheet released by the White House, the U.S.-Canada Free Trade Agreement is a "win-win" situation for both countries

In the case of the U.S.-Mexico Free Trade Agreement, the disparity is great. It is a case of a rich and developed country trading with a poor and developing country with a much smaller economy. As a result, the perception of many segments of the United States is that one country (i.e., Mexico) will gain and that another (the United States) will lose since jobs created in Mexico represent jobs eliminated in the United States. Opponents allege that the free trade agreement represents a desire to exploit cheap Mexican labor. There are also concerns about social and environmental protection because Mexico's environmental standards and enforcement are inadequate.

Some Mexicans also oppose the free trade pact, believing that the agreement may lead ultimately to an economic or political union. The union may require Mexico to give up its sovereignty and currency.

Any debate should discuss merits and flaws of the arguments of those who oppose the U.S.-Mexico Free Trade Agreement.

There is no question that a NAFTA will benefit certain workers while adversely affecting some others. U.S. unions' opposition is understandable due to the fact that U.S. job gains will occur primarily outside the unions.

Regarding the fear of U.S. wages being depressed, it should be pointed out that the accession of Greece, Spain, and Portugal to the EU did not depress real wages within the EU as real manufacturing wages actually rose in Germany, France, and the United Kingdom by at least 20 percent during the 1980s. The wage disparities between the United States and Mexico, although considerable, are no greater than those between Portugal and Germany.

The arguments of organized labor are inconsistent. On the one hand, it has expressed a concern that there is a potential for massive immigration from Mexico which will depress U.S. wages. On the other hand, organized labor usually believes that problems in the developing countries can be solved by raising wages there and not lowering U.S. wages. The pact should increase investor confidence in Mexico and increase Mexican wages, exactly what U.S. labor groups have argued for. Higher wages in Mexico thus should slow the rate of Mexican immigration into the United States. The increasing trade with the United States has offered no evidence of depressed wages in the United States.

Furthermore, regarding U.S. labor's concern with the migration of U.S. plants across the border, it should be pointed out that American corporations already have the option of locating in the special *maquiladora* zones along the border. Also *maquiladoras* are the segment of the Mexican economy in which wage rates are rising fastest.

While environmental groups in the United States contend that Mexico has lax regulations, it must be pointed out that such regulations are unlikely to improve without the pact. Furthermore, empirical evidence has shown that environmental regulation and economic growth are positively--not negatively--related. It is questionable, however, to assume that free trade (and growth) and a better environment must be conflicting goals. Actually, overwhelming evidence shows that growth creates both the desire and the means to improve the environment. As Mexico becomes become wealthier, like other countries, it is likely to demand, and can afford, a healthier environment.

Both countries should benefit from the free trade pact which plays to each country's comparative advantage. The two economies are complementary, especially in terms of the relative availability of capital and labor in the two countries. Furthermore, the emergence of economic blocs makes it imperative that both the United States and Mexico adjust to a more competitive world.

It is obvious that certain groups in all three countries have benefited from protectionism, and it is thus anything but surprising that they oppose a NAFTA.

However, the implementation of NAFTA has created the world's largest free trade area which should result in more jobs, lower prices, and greater consumer choices. As the pie gets bigger, everyone gets a bigger slice.

Mexico is important because it is a sizable market whose population is growing. Furthermore, Mexico is a top U.S. customer. Due to geographic proximity, Mexicans are comfortable and familiar with U.S. products. Growth will enlarge Mexico's consumer base.

Since free trade will improve the relationship between the United States and Mexico, economic ties will enhance each country's ability to deal with such important issues as the environment, narcotics, immigration, human rights, and worker standards. The United States cannot stem the flood of illegal immigration and drugs unless Mexico is a stable and prosperous nation. As noted by President Vicente Fox, Mexico has moved from No. 15 to become the ninth-largest economy in the world. At the same time, NAFTA has hastened democracy in Mexico, transforming the country from a single-party dominated government to a multiparty democracy.

A Concluding Note

See "NAFTA: 10 Years Later," *San Jose Mercury News*, 27 December 2003; Jeffrey E. Garten, "At 10, NAFTA Is Ready for an Overhaul," *Business Week*, 22 December 2003, 32; "Mexico," *Business Week*, 22 December 2003, 66ff; and Jeffrey J. Schott and Gary C. Hufbauer, *NAFTA: A Ten-Year Appraisal*, 2004.

Ten years later, NAFTA has once again become a political issue. Senator John Edward, campaigning in 2004 to become a presidential nominee of the Democratic Party, repeatedly stated his opposition to the treaty. In 2008, both Hillary Clinton and Barack Obama echoed the same sentiment.

NAFTA is unique in the sense that it was the most comprehensive trade agreement among a wealthy industrial nation (the United States), a small industrialized nation (Canada), and a developing economy (Mexico). NAFTA pioneered trade agreements of labor and environmental standards.

Trade among the three NAFTA members doubled from $306 billion in 1993 to almost $621 billion in 2003, a 109 percent increase. American agricultural exports to Mexico have doubled. At the same time, the U.S. trade deficit with its two partners jumped nine-fold to nearly $90 billion. U.S. trade with Mexico has grown three times as fast as it did before NAFTA, while U.S. direct investment in Mexico has increased at more than double its rates of increase with non-NAFTA countries.

It is difficult to definitely show what might have happened without NAFTA. Some blame NAFTA for the loss of U.S. apparel jobs that were transferred to Mexico, the same jobs that were later moved to Central America and Asia. Arguably, without NAFTA, such jobs would have been lost anyway, and these jobs would have moved directly to Central America and Asia. Therefore, NAFTA should be blamed for the movement of jobs to China.

It is not easy to figure out the jobs gained and lost due to NAFTA. The Economic Policy Institute, backed by labor unions, pegged the net loss for the United States at 879,280 jobs, while admitting that such losses were modest when considering the size of the U.S. economy. On the other hand, the Labor Department's Employment & Training Administration found that 507,358 U.S. jobs were lost between October 1993 and September 2002. By late 2002, the Labor Department stopped the practice and has begun to calculate jobs lost to international trade (and not just NAFTA). Certainly, the effects of NAFTA cannot be isolated from the activities of a global economy.

According to a senior analyst at the Institute for International Economics, the United States greatly benefits from lower priced consumer goods and increased corporate profits. These gains, however, are thinly spread across the nation to the point that consumers are not aware of them. In contrast, the Midwest and other places have suffered the concentrated effect of job losses. At least, half a million American manufacturing workers lost their jobs.

5. Should the United States advance NAFTA to the next stage to become, say, a common market? Or instead of vertical advancement, should the United States push for horizontal advancement by creating the FTAA?

If NAFTA can advance vertically by moving on to the next level of economic cooperation (e.g., a common market), the member countries should benefit from greater trade while utilizing each country's comparative advantage. However, the migration of labor is a very sensitive issue. It is understandable as to why former President Vicente Fox of Mexico has advocated some type of a common market, Canada and the United States are not receptive to free movement of labor. In the United States, due to job losses, almost all politicians are unlikely to advocate entry of Mexican workers--legal and illegal. Illegal Mexican immigrants in the United States more than doubled between 1990 and 2000 to 4.8 million.

A monetary union for the three NAFTA members is also extremely unlikely. In spite of its soft currency, Mexico is not willing to give up its peso. Canada, likewise, wants to keep its national currency. In the case of the United States, with the U.S. dollar as the most popular currency in the world, there is virtually no way that the country will agree to give up its currency in favor of a new currency (e.g., NAFTA dollar).

NAFTA, as a free trade agreement, has brought a number of benefits. Yet workers, economists, politicians, and policymakers are still debating the benefits and problems of NAFTA. There are always some people in any of the three member countries who are unhappy with NAFTA. Even Mexico (which seems to be the one deriving the greatest benefits) is not completely happy with NAFTA either. Delphi Corp. has an auto-parts plant in Ciudad Juarez that employs 70,000 Mexicans; but the company is also thinking about shifting some work to China. While the number of *maquiladoras* has gone up to 3,655, about 850 have also shut down since 2000. One irony is that NAFTA has made it possible for subsidized U.S. foods to flood Mexico, wiping out 1.3 million farm jobs.

China has now replaced Mexico as the No. 2 supplier of the United States. China is formidable because of its aggressive tax incentives, low wages, worker training, etc. An assembly worker in Mexico makes $1.47 an hour, while the rate is 59 cents in China. While Mexico has nearly doubled the number of science and engineering college graduates to 73,300, India and China have graduated 314,000 and 363,000 respectively.

Instead of a vertical move, the United States has been promoting the FTAA as a horizontal move by simply adding a very large number of countries. Mexico, likewise, has signed trade agreements with 32 countries. For example, in 2002, Mexico and Brazil signed the Complementary Economic Accord. The accord was expanded in 2004.

In theory, any type of economic cooperation will bring significant benefits. In practice, the FTAA is anything but easy. The sheer size of membership is one problem. Another difficulty has to with the varying size of these potential members. Furthermore, the level of economic development also greatly varies.

A 2003 poll of 17 Latin countries found that only 16 percent of respondents were satisfied with market economics in their countries.

In early 2004, talks on a Free Trade Area of the Americas broke down. There are disagreements between the United States and Brazil, and the hotly contested topics include agricultural subsidies and intellectual property. Many nations now focus on bilateral negotiations instead.

As stated by former Mexican President Carlos Salinas, "you have to run faster and faster if you want to stay in the same place. Globalization won't wait for you."