Europe as Protagonist[1]

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1 The first part of this piece draws heavily from Wayne Sandholtz and John Zysman, "1992: Recasting the European Bargain", World Politics, Vol. XLII, No. 1 (October 1989), pp. 95-128.

Europe is in metamorphosis, reshaping itself and its role in the world. The <u>bargain</u> that is the European Community is being recast by its present members through a process loosely labeled "1992". More profoundly, Europe is being <u>redefined</u>. It is not simply that Austria and Sweden are applying for membership, but that Central -- once labeled Eastern -- Europe is being reintegrated into the West. Finally, Europe's place in the global system is being <u>reset.</u> However labeled, the bold changes are themselves a product of shifts in the international system that are altering the options for and constraints on the several European governments.

Dramatic changes in the power and purposes of allies and rivals -- a change in the international system -- have provoked this European transformation. In a first phase, the spark, we argue, was the relative decline of the United States and the emergence of Japan as an economic power; the European Community responded with renewed movement toward a single market. In a second phase, the retreat of Soviet power from central Europe probably accelerated the discussion of monetary union as a means of addressing the place of Germany in Europe. We must distinguish between the domains of trade and finance -- where common European purposes, institutions, and commitments are emerging -- and the domains of politics and security -- where common purposes and institutions for pursuing them are by no means clear. In any case, Europe remains a bargain amongst governments. It has not yet defined itself as a protagonist in the international system (and may never do so). A redefined and recast Europe could have an interest in managed multilateralism or regional autonomy. The character of international arrangements Europe finds congenial will emerge through the process of Europe's transformation.

Under the banner of "1992," the European Communities are putting in place a series of political and business bargains that will recast, if not unify, the European market. This initiative is a disjunction, a dramatic new start, rather than the fulfillment of the original effort to construct Europe. The removal of all barriers to the movement of persons, capital and goods among the twelve member states (the formal goal of the 1992 process) is expected to increase economies of scale and decrease transaction costs. But these one-time economic benefits do not capture the full range of purposes and consequences of 1992.[2] Dynamic effects will emerge in the form of restructured competition and changed expectations. Nineteen ninety-two is a vision as much as a program -- a vision of Europe's place in the world. The vision is already producing a new awareness of European strengths and a seemingly sudden assertion of the will to exploit those strengths in competition with the United States and Japan. It is affecting companies as well as

2 See Centre for Business Strategy, <u>1992 Myths and Realities</u> (London: London Business School, 1989).

governments. A senior executive of Fiat declared, "The final goal of the European 'dream' is to transform Europe into an integrated economic continent with its specific role, weight and responsibility on the international scenario *vis-a-vis* the U.S. and Japan."[3]

We propose that changes in the international system triggered the 1992 process. More precisely, the changes consisted of a real shift in the distribution of economic power resources (crudely put, relative American decline and Japanese ascent). Just as important, European elites perceive that the changes in the international setting require that they rethink their roles and interests in the world. The United States is no longer the unique source of forefront technologies; in crucial electronics sectors, for example, Japanese firms lead the world. Moreover, Japanese innovations in organizing production and in manufacturing technologies mean that the United States is no longer the most attractive model of industrial development. In monetary affairs, some Europeans argue that Frankfurt and Tokyo, not Washington, are now in control. In short, shifts in relative technological, industrial, and economic capabilities are forcing Europeans to rethink their economic goals and interests as well as the means appropriate for achieving them. American coattails, they seem to have concluded, are not a safe place when the giant falters and threatens to sit down. American leadership in the war against Iraq might seem a harbinger of renewed American initiative. But the war also shows that military force is the sole area in which the United States is clearly pre-eminent; President Bush had to pass the hat among U.S. allies to pay for the effort.

While economic changes have triggered the 1992 process, security issues are shaping its outcomes. The European economic relationship with the United States has been embedded in a security bargain that is being reevaluated. This is not the first reassessment of the alliance, but this time it takes place against the retreat of Soviet power from central Europe. The point is that the security ties that underpinned U.S.-European economic relations are being reconsidered in Europe. We need not look deeply into the security issues to understand the origins of the 1992 movement, though some believe that the nuclear horsetrading at Reykjavik accelerated the 1992 process.[4] Now, however, the economic and security discussions are beginning to shape each other.

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3 Clemente Signoroni, "The ECU, a success Factor for the 1993 Community Market," address in Madrid, 12 January 1989, p. 6.

4 Enrique Baron, Europe 92: Le Rapt du Futur (Paris: Editions Bernard Coutas, 1989), p. 88.

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The First Phase

1992: Recasting the European Bargain

The central proposition of this essay is that structural change was a necessary, though not a sufficient, condition for the renewal of the European project. The creation in the 1950s as well as the renewal in the 1980s can be fruitfully analyzed as a hierarchy of bargains. In response to structural changes in the international system, fundamental bargains are struck embodying basic objectives; subsidiary bargains are required to implement these objectives. Europe was created as and remains a bargain amongst governments. But a broader group of elites helps generate the ideas and vision, sets the context for bargaining, and pushes the process forward.

The Original Movement:

The original European movement can be seen in terms of this framework.[5] The integration movement was triggered by the wrenching structural changes brought about by World War II; after the war, Europe was no longer the center of the international system but rather a frontier and cushion between the two new superpowers.[6] Political entrepreneurship came initially from the group surrounding Robert Schuman and Jean Monnet. The early advocates of integration succeeded in mobilizing a transnational coalition supportive of integration; the core of that coalition eventually included the Christian Democratic parties of the original Six plus many of the Socialist parties.[7]

The fundamental objectives of the bargains underlying the European Coal and Steel Community (ECSC) and the expanded European Communities were primarily two: 1)the binding of German industry to the rest of Europe so as to make another war impossible, and 2)the restarting of economic growth in the region. These objectives may have been largely implicit, but they were carried out by means of a number of implementing bargains that were agreed upon over the years. The chief implementing bargains after the ECSC included the Common Market, the Common Agricultural Program, the regional development funds,[8] and, most recently, the European Monetary System (EMS).

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5 We have no intention of providing a detailed history of the EEC; that story has been well told many times. We seek only to show that the major elements of that history fit the analytical framework we are proposing here.
6 Of course, many of the early students of European integration recognized that structural changes due to the war were crucial in triggering the process. See for example Lindberg and Scheingold, Europe's Would-be Polity, (Englewood Cliffs, New Jersey: Prentice-Hall, 1970), especially chapter 1.
7 See Walter Yondorf, "Monnet and the Action Committee: The Formative Period of the European Communities," International Organization, 19 (Autumn 1965).
8 The regional development funds had a precursor in development programs created at Italy's insistence in 1956. They acquired more importance after the accession of Britain and Ireland, and have become vital elements of the EC bargain since the addition of Greece, Spain, and Portugal.

The fundamental external bargain made in establishing the Community was with the United States; it called for (certainly as remembered now in the U.S.) national treatment for the subsidiaries of foreign firms in the Common Market. That is, foreign (principally American) firms that set up in the Community could operate as if they were European. American policy-makers saw themselves as willing to tolerate the discrimination and potential trade diversion of a united Europe because the internal bargain of the EEC would contribute to foreign policy objectives. Not only was part of Germany tied to the West, but sustained economic growth promised political stability. All of this was framed by the security ties, seen as necessary on both sides of the Atlantic, to counter the Soviet Union.

The European bargains -- internal and external -- were made at the moment of American political and economic domination. A bipolar security world and an American-directed Western economy set the context in which the European bargain appeared necessary. Many expected the original Community to generate ever more extensive integration. But the pressures for spillover were not that great. Economics could not drive political integration. The building of nation states remains a matter of political projects. Padoa Schioppa has put it simply and well: "The cement of a political community is provided by indivisible public goods such as 'defence and security'. The cement of an economic community inevitably lies in the economic benefits it confers upon its members."[9] The basic political objectives sought by the original internal bargain had been achieved: the threat of Germany was diminished and growth had been ignited. When problems arose from the initial integrative steps, the instruments of national policy sufficed to deal with them. Indeed, the Community could accommodate quite distinct national social, regulatory, and tax policies. National strategies for growth, development and employment sufficed.

Several fundamental attributes of the economic community that emerged merit emphasis, as they proved important in the reignition of the European project in the mid-1980s. First, the initial effort was the product of inter-governmental bargains. Second, there was the partial creation of an internal market; that is, a reduction but not an elimination of the barriers to internal exchange. The success of this initiative was suggested by the substantial increase in intra-European trade. Third, and equally important, there was toleration of national economic intervention; in fact, in the case of France, such intervention was an element of the construction. There was an acceptance of national strategies for development and political management. Fourth, the European projects were in fact quite limited, restricted for the most part to managing retrenchment in declining industries and easing dislocations in the rural sector (and consequently managing the politics of agriculture) through the Common Agricultural Policy. There were

9 Tommaso Padoa-Schioppa, Efficiency, Stability and Equity (Oxford: Oxford University Press, 1987).

several significant exceptions, including the European Monetary System which emerged as a Franco-German deal to cope with exchange rate fluctuations that might threaten trade relations; however, the basic principle of national initiative persisted. Fifth, trade remained the crucial link between countries. Joint ventures and other forms of foreign direct investment to penetrate markets continued to be limited. Sixth, American multinationals were accepted, if not welcomed, in each country.

When the global context changed, the European bargains had to be adjusted for new realities. Wallace and Wessels have argued that "even if neither the EC or EFTA had been invented long before, by the mid-eighties some form of intra-European management would have had to be found to oversee the necessary economic and industrial adjustments."[10]

The structural changes we have been depicting do not "cause" responses. Structural changes pose challenges and opportunities. They present choices to decision-makers. Three broad options, individually or in combination, were open to the countries of the EC. First, each nation could seek its own accommodation through purely national strategies; but for reasons we explore below, going it alone appeared increasingly unpalatable. Second, Europe could adjust to Japanese power and shift ties from the U.S. to Japan. But the Japanese option had significant counts against it: 1)there were no common security interests with Japan to undergird the sorts of relations Europe has had with the United States; and 2)Japan has so far been unwilling to exercise a vigorous leadership role in the international system. The third option was that Europe could attempt to restructure its own position to act more coherently in a changing world. The international changes did not produce 1992; they provoked a rethinking. The 1992 project emerged because the domestic context was propitious and policy entrepreneurs fashioned an elite coalition in favor of it.

Political Entrepreneurship and the New European Bargain: Structural change was a trigger for the original European project; it was a trigger for its renewal. Other factors were equally necessary and, in combination, sufficient for the fundamental bargains to be remade and new subsidiary bargains to be engaged.

The surprisingly sudden movement by governments and companies toward a joint response does not have a clear and simple explanation. Uncertainty abounds. In a situation so open, so undefined, political science must rediscover the art of politics. The 1992 movement cannot be understood as the unique, logical response to a situation in which actors and groups found themselves, and cannot, therefore, be understood through such formal tools as theories of

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10 Helen Wallace and Wolfgang Wessels, Towards a New Partnership: The EC and EFTA in the Wider Western Europe, Occasional Paper No. 28, European Free Trade Association, Economic Affairs Department (March 1989), p. 4.

games or collective action. Neither the payoff from nor preferences for any strategy were, or are yet, clear.[11] European choices have been contingent on leadership, perception, and timing; they ought to be examined as an instance of elites constructing coalitions and institutions in support of new objectives.[12]

This is not a story of mass movements, of pressure groups, or of legislatures. In the 1950s, the European project became a matter of party and group politics. In the 1980s, the EC institutions were not the object of debate but were political actors. Indeed, the Commission exercised leadership in proposing technical measures for the internal market that grabbed the attention of business and government elites but were (in the initial stages at least) of little interest to the organs of mass politics. The governments and business elites had already been challenged by the international changes in ways that the parties and unions had not been. Some business and government leaders involved in 1992 are, in fact, trying to sidestep normal coalition politics in order to bring about domestic changes.

Consequently, any explanation of the choice of Europe and its evolution must focus on the actors. The actors -- the people who confronted the changes in the international environment and initiated the 1992 process -- consisted of the leadership in the institutions of the European Community, in segments of the executive branch of the national governments, and in the

11 Strategic games are useful heuristic devices that can help us reason about structured situations by clarifying the logic of interaction. In this instance, whatever the general methodological case, substantial investment in specifying and manipulating a multi-player, multi-issue game will have limited pay-offs in our understanding of 1992. Indeed, the crucial analytic issues must be resolved long before a set of games can even be devised. Games of strategic interaction require preference functions for each player. With 1992, decision-makers do not possess the intellectual means to foresee alternative outcomes, much less rank them. Game theory, as even its most enthusiastic proponents recognize, cannot yet deal with changing preferences. Given all of these lacunae and uncertainties, game models of the international interactions involved in 1992 cannot possibly capture the political dynamics that matter. Behind the games are the crucial factors: political strategies, constraints and leadership.

Nor is this really a problem for theories of collective action, as traditionally conceived in political science. The problem is not one of inducing actors to contribute to production of a collective good (i.e., avoiding free riders). The institutional structure of the community compels participation and shared leadership. At issue are the areas that should be opened to joint policy-making and the institutional arrangements that might prove acceptable to the parties. Not only are there substantial risks and costs for all, but imposing European decisions on domestic politics requires domestic political action by the national executive, not just acquiescence in the European Commission and Council of Ministers. There are, in other words, multiple layers of politics.

12 This is not a matter of elite learning that can be explained by theories of learning. Our proposition would clearly be that changed circumstances, not increased knowledge, have altered behavior. By knowledge we would mean formally specified relationships (information and theories about it) that suggest what outcomes will result from what causes. It is not a better understanding of an existing situation, but the discovery of a new situation that is at issue. The necessary ingredient for adaptation is therefore vision and leadership, an image of arrangements or relationships that will respond to new tasks and the skill to mobilize diverse groups to construct that future. It is not greater technically rooted knowledge, but politically founded insight that is called into play.

business community (principally the heads of the largest companies).[13] Each of these actors was indispensable, and each was involved with the actions of the others. The Commission itself is an entrenched, self-interested advocate of further integration, so its position is no surprise. The multinationals are faced with sharply changed market conditions, and their concerns and reactions are not unexpected. The initiatives came from the EC (originally from the European Parliament and its Draft Treaty on European Union), but they caught hold because the nature of domestic political context had shifted. Tracing the negotiating history of the Single European Act inevitably focuses on the governmental bargains. But the bargaining must be situated in an analysis of what led governments to rethink their conceptions of interests, to redefine their strategies for old goals, and to identify new goals[14]. Casting the analytic net more broadly draws in the Commission and the business elites, as well as the shifting political context of Europe. The interconnections and interactions among the several actors will almost certainly defy an effort to assign primacy, weight, or relative influence.[15]

National governments are at the center of Community politics, and some national governments -- particularly the French -- have begun to approach old problems in new ways and to make choices that are often unexpected. The question is why national government policies and perspectives have altered. Why, in the decade between the mid-1970s and the mid-1980s, did European governments become open to European-level, market-oriented solutions? The answer has two parts: the failure of national strategies for economic growth and the transformation of the left in European politics. First, the traditional models of growth and

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13 We have attempted (without fully succeeding) to distinguish between the politics of coalitions and the role of institutions in shaping the present response. In the first European movement that established the Coal and Steel Community, and then the EEC, there were no European institutions shaping and activating the players. Now there are, and the game is consequently quite different. The most important "spillover" probably lies in the creation of a permanent advocate of more extensive integration, and a location for such developments to occur.

14 Andrew Moravcsik "Negotiating the Single European Act" Winter 1981 International Organization. Moravscik seeks to distinguish his position from our view, presented in World Politics, by laying emphasis on the governmental deals leading to the Single European Act. Each article identifies and acknowledges the role of identical elements; each notes the community is a bargain amongst governments; each notes the changing political context at the national level that created the basis in which governments could make new bargains. Except in emphasis these tales do not differ, and each version can support the argument of the other author. Several points need clarifying. We find it confusing to be shoved into a neo-functionalist category because of our use of the word "elites". Our argument explicitly contends that the neo-functionalist spill-over process would not have produced a new bargain. It argues that the community actors were crucial in the recasting of the bargains and in the process of redefining conceptions. We place greater emphasis than does Maoravscik on Community institutions and business sector involvement. Moravscik focuses on the details of the negotiations; we try to capture the broader international and institutional context. He trains his analytic eye on the Single Act; we examine the larger movement called "1992".

15 The analytic histories of the new Europe are now beginning to appear. One of the best is David Cameron, unpublished work, forthcoming.

economic management broke down. The old political strategies for the economy seemed to have run out. After the growth of the 1960s, the world economy entered a period of stagflation in the 1970s. As extensive industrialization reached its limits, the existing formulas for national economic development and the political bargains underpinning them had to be revised. Social critics and analysts defined the crisis as the failure of established formulas to provide even plausible guides for action.[16] It was not simply that the price of commodities rose, but that the dynamics of growth and trade changed.[17]

Growth had been based on the shift of resources out of agriculture into industry; industrial development had been based on borrowing from abroad the most advanced technologies that could be obtained and absorbed. Suddenly, many old industrial sectors had to be closed, as was the case with shipbuilding. Others had to be transformed and reorganized: factories continuously upgraded, new machines designed and introduced, and work reorganized. The arguments that eventually emerged held that the old corporate strategies based on mass production were being forced to give way to strategies of flexibility and adaptability.[18] Despite rising unemployment, the steady pace of improvement in productivity, coupled with the maintenance and sometimes reestablishment of a strong position in production equipment for vital sectors, suggested that Europe's often distinctive and innovative approaches to production were working. However, that was only to come toward the end of the decade. In short, during the 1970s, national executive and administrative elites found themselves facing new economic problems without adequate models for addressing them.

The 1970s were therefore the era of Europessimism. Europe seemed unable to adjust to the changed circumstances of international growth and competition after the oil shock. At first, the advanced countries stumbled, but then the United States and Japan seemed to pick themselves back up and to proceed. Japan's growth, which had originally been sustained by expansion within domestic markets, was bolstered by the competitive export orientation of major firms in consumer durables. New approaches to manufacturing created substantial advantages.[19] In the United States, flexibility of the labor market -- meaning the ability to fire workers and

16 Stephen Cohen, "Informed Bewilderment," in Stephen Cohen and Peter Gourevitch, eds., France in A Troubled World Economy (London: Butterworth, 1983). Cohen makes this point here in a particularly clear and jargon free fashion.

17 See John Zysman, Governments, Markets, and Growth (Ithaca, New York: Cornell University Press, 1983), Chapter 1.

18 There is both a European and an American school of discussion. In the United States, the debate is led by Charles Sabel and Michael Piore. Their book, The Second Industrial Divide (New York: Basic Books, 1984), brought many of the issues into the public arena, though the scholarly work underlying it is much more important. In Europe the group is diverse, including Robert Boyer, Benjamin Coriat, Giovanni Dosi, and Jacques Mistral. A particularly interesting version of the debate is found in Peter Hall, ed., International Journal of Political Economy: European Labor in the 1980s, 17 (Fall 1987).

19 Robert Boyer makes this point particularly well in a diverse set of his papers.

reduce real wages -- seemed to assure jobs, albeit in services and often at lower wages, despite a deteriorating industrial position in global markets. Japan experienced productivity growth; the United States created jobs. Europe seemed to be doing neither, and feared being left behind by the U.S.-Japanese competition in high technology.

For Europe the critical domestic political issue was jobs, and the problem was said to be labor market rigidity. In some sense that was true, but the rigidities did not lie exclusively or even primarily with worker attitudes. They were embedded in government policy and industrial practice. In most of Western Europe, the basic post-war political bargain involved governmental responsibility for full employment and a welfare net. Consequently, many European companies had neither the flexibility, to fire workers or reduce wages, of their American counterparts, nor -- broadly across Europe -- the flexibility Japan displayed in redeploying its labor force.[20] As unemployment rose, the old growth model built on a political settlement in each country was challenged -- initially from the left by strategies of nationalization with state investment, and, then, from the right by strategies of deregulation with privatization. The political basis, in attitude and party coalition, for a more market-oriented approach was being put in place.

For a decade, beginning with the oil shocks, the external environment for Europe was unstable -- turbulent, if you will -- but its basic structure was unchanged. While the United States was unwilling or unable to assure a system of fixed exchange rates, it remained the center of the financial system even as it changed the rules. The European Monetary System was an effort to create a zone of currency stability so that the expansion of trade inside Europe could continue. In the 1960s and 1970s, a long debate on technology gaps and the radical extension of American multinational power had not provoked joint European responses. During the 1970s, the mandate for the European Community was not altered, but stretched to preserve its original objectives in the original context. The international economic turbulence and fears of a relative decline in competitive position of the 1970s did not provoke a full blown European response. The extent of the shifts in relative economic power was not yet apparent. National strategies in many arenas had not yet failed, or, at least, were not yet perceived as having failed. In other arenas, the challenges could be dealt with as accommodations within the realm of domestic politics.

The question remains: Why did national policy change; why did the perceptions of choice evolve, the range of options shift? Policy failure must be interpreted, and can be assigned many meanings. National perceptions of position are filtered through parties and bureaucracies, shaped and flavored by factions, interests, and lobbies. For instance, in 1983, the French

20 There was a another twist, as well: David Flanagan at Stanford has argued that companies hesitated to invest in training new workers, and that when they had to expand, tended to hire back those that had been laid off, creating a substantial pool of young unemployed.

Socialist Party was divided between those led by Laurent Fabius, who concluded that pressure on the franc was a reason to reverse policy direction and to stay within the European Community, and those such as Chevenement who felt the proper choice was to withdraw from the EMS, even if that resulted in an effective weakening of the Community. The choice to stay in the EMS was by no means a foregone matter.[21] The French response to the currency crisis was a political choice made in the end by the president.

Thus, the second aspect of the changed domestic political context was the shift in government coalitions in a number of EC member states. Certainly, the weakening of the left in some countries and a shift from the communist to the market-socialist left in others helped to make possible a debate about market solutions (including unified European markets) to Europe's dilemma. In Latin Europe, the communist parties weakened as the era of Eurocommunism waned. Spain saw the triumph of Gonzalez's socialists, and their unexpected emergence as advocates of market-led development and entry into the Common Market. Italy experienced a weakening of the position of the communists in the complex mosaic of party positioning. In France, Mitterrand's victory displaced the communists from their primacy on the left. The first two years of the French socialist government proved crucial in turning France away from the quest for economic autonomy. After 1983, Mitterrand embraced a more market-oriented approach and became a vigorous advocate of increased European cooperation. This had the unexpected consequence of engendering independence for the state-named managers of nationalized companies. When the conservative government of Jacques Chirac adopted deregulation as a central policy approach, a second blow was dealt to the authority of the French state in industry. In Britain and Germany, the Labour and Social Democratic Parties lost power as well as influence on the national debate.

Throughout the Community, the corporatist temptation waned; that is, management of the macro-economy through direct negotiations among social groups and the government no longer seemed to work. In many union and left circles, an understanding grew that adaptation to market processes would be required. (As the 1992 movement progressed, unions in most countries became wary that the European "competitive imperative" might be used to justify

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21 There is a parallel story in Britain some fifteen years earlier. In the early 1960s, the British Labour Party had refused to devalue the pound sterling even when it meant effectively abandoning a growth strategy. The debate on sterling was suppressed within the party; the outcome was settled only when there was truly no choice left. See Stephen Blank, "Britain: The Politics of Foreign Economic Policy," in Peter Katzenstein, ed., Between Power and Plenty (Madison, Wisc.: University of Wisconsin Press, 1978); Anthony Howard, ed., The Crossman Diaries, Selection from the Diaries of a Cabinet Minister 1964-1970 (London: Methuen Paperbacks, 1979).

policies that would restrict their influence and unwind their positions and gains.[22] As a counterpoint on the right, Thatcher began to fear a bureaucratized and socialized Europe.)

In an era when deregulation -- the freeing of the market -- became the fad, it made intuitive sense to extend the European internal market as a response to all ailments. Moreover, some governments, or some elites within nations, can achieve purely domestic goals by using European agreements to limit or constrain national policy choices. The EMS is not only a means of stabilizing exchange rates to facilitate trade, but also a constraint on domestic politics that pushes toward more restrictive macroeconomic policies than would otherwise have been adopted. There is little doubt that the course of the social experiment in 1981 would have been different if France had not been a member of the EMS, which required formal withdrawal from commitments if a country wanted to pursue independent expansionary policies. In a different vein, some Italians use the threat of competitive pressures as a reason to reform the administration. As one Italian commentator put it, "Europe for us will be providential. . . . The French and Germans love 1992 because each thinks it can be the key country in Europe. The most we can hope for is that 1992 straightens us out."[23]

In any case, Europe witnessed the creation of like-minded elites and alliances that at first blush appeared improbable -- such as Mitterrand and Thatcher committed to some sort of European strategy. These elites are similar in political function (though not in political basis) to the cross-national Christian Democratic alliance that emerged after World War II in Germany, France, and elsewhere in support of the original Community. European-level, market-oriented solutions have become acceptable.

This was the domestic political soil into which the initiatives emerging from the European Parliament, and the Commission, fell. Traditional models of economic growth appeared to have played themselves out, and the left had been transformed in such a way that socialist parties began to seek market-oriented solutions to economic ills. In this setting, the European Community provided more than the mechanisms of intergovernmental negotiation. The Eurocracy was a standing constituency and permanent advocate of European solutions and greater unity. Proposals from the Parliament, taken up by the Commission and modified by the Council, transformed this new orientation into policy, and, more importantly, into a policy perspective and direction. The Commission perceived the international structural changes and the failure of existing national strategies, and seized the initiative.

To understand how European initiatives led governments to step beyond failed national policy, let us examine the case of telematics, the economically crucial sector combining

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22 Hall, Op. Cit.

23 Philip Revzin, "Italians Must Change Their Business Style in Integrated Europe," Wall Street Journal, 21 November 1988, p. 1. Italian businessmen quoted in the article express the same sentiment.

microelectronics, computers, and telecommunications. By 1980, European policy-makers were beginning to realize that the national champion strategies of the past decade or so had failed to reverse the steady international decline of European telematics industries. Throughout the 1970s, each national government in Europe had sought to build up domestic firms capable of competing with the American giants. The state encouraged or engineered mergers and provided research and development grants; state procurement heavily favored the domestic firms. But by 1980, none of these approaches had paid off. Europe's champions were losing market shares both in Europe and worldwide, and most of them were operating in the red. Even Europe's traditional electronics stronghold, telecommunications equipment, was showing signs of weakness: the telecommunications trade surplus was declining annually, while U.S. and Japanese imports were accounting for ever-larger shares of the most technologically advanced market segments.[24]

In telematics, European collaboration emerged when the Commission, under the leadership of Commissioner Etienne Davignon, struck an alliance with the twelve major electronics companies in the EC. The twelve firms designed the European Strategic Programme for Research and Development in Information Technology (ESPRIT), and then sold it to their governments. The RACE program (Research for Advanced Communications-technologies in Europe) emerged via a similar process.[25] In short, the Community's high-technology programs of the early 1980s took shape in a setting in which previous national policies had been discredited; the Commission advanced concrete proposals, and industry lent essential support. In a sense, the telematics cases prefigure the 1992 movement and display the same configuration of political actors: the Commission, certain political leaders and specific agencies within the national governments, and senior business leaders.

The Commission again took the initiative with the publication of its "White Paper" in June, 1985. The initiative should be seen as a response to the stagnation of the Community enterprise as a result of, among other things, the budget stalemates. When Jacques Delors took office as President of the European Commission in 1985, he consciously sought an undertaking, a vision, that would reignite the European idea. He seized upon internal market proposals that had circulated between the European Council and the Commission in the early 1980s. The notion of a single market by 1992 caught the imagination because the need for a broader Europe was perceived outside the Commission. Helen Wallace and Wolfgang Wessels suggest that if

24 Michael Borrus et al., Telecommunications Development in Comparative Perspective, BRIE Working Paper No. 14 (Berkeley, Calif.: BRIE, 1985), p. 38.
25 This is a radical simplification but it captures the essence of events. For more detail, see Wayne Sandholtz, High-Tech Europe: The Politics of International Cooperation (Berkeley, Calif.: University of California Press, 1991).

the EEC and the European Free Trade Association (EFTA) had not existed by the late 1980s, they would have had to be invented. [26] Or, as was the case, reinvented.

The White Paper set out a program and a timetable for the completion of the fully unified internal market.[27] The now famous set of three hundred legislative proposals to eliminate obstacles to the free functioning of the market, as well as the analyses that led up to and followed it, expressed a clear perception of Europe's position.[28] European decline or the necessities of international competitiveness (choose your own phrasing) require -- in this view -- the creation of a continental market.

The White Paper's program had the political advantage of setting forth concrete steps and a deadline. The difficult political questions could be obscured by focusing on the mission and by reducing issues to a series of apparently technical steps. Advocates of market unification could emphasize highly specific, concrete, seemingly innocuous, and long overdue objectives rather than their consequences.[29] In a sense, the tactic is to move above and below the level of controversy. The broad mission is agreed to; the technical steps are unobjectionable. Of course, there is a middle ground where questions about the precise form of Europe, the allocation of gain and pain in the process, become evident. A small change in, say, health and safety rules may appear unimportant, but may prove to be the shelter behind which a national firm is hiding from European and global competitors. Here we find the disputes about outcomes, both in terms of market results and of social values. Obscuring issues and interests was crucial in developing Europe the first time, one might note, and has been instrumental once again.

Implementation of the White Paper required a separate initiative: the limitation, expressed in the Single European Act, of national vetoes over Community decisions. At its core, the Community has always been a mechanism for governments to bargain. It has certainly not been a nation state, and has been only a funny kind of federalism. Real decisions have been made in the Council by representatives of national governments. The Commissioners, the

26 Wallace and Wessels, Op. Cit.

27 Michael Emerson, 1992 and After. The White Paper proposals can be grouped into sets.

1. Liberalization of government Procurement; essentially opening national procurement to outside bidders.
2. Technical norms; the largest number of proposals set technical standards that otherwise preclude movement of goods through Europe
3. Transport services.
4. Agricultural border taxes and subsidies.
5. National restrictions in the community's external trade relations; these matters are not strictly an element of the "internal bargain" but are included here to be completer.
6. Abolition of fiscal frontiers; there would be no need to assess taxes at the border.
7. Financial services, including banking, stock markets, and related services and insurance; this set aims boldly at creating a European captial market.

28 Padoa-Schioppa Op. Cit.; Michael Emerson Op. Cit.; Paolo Ceccini, The Cost of Non Europe.

29 "Europe's Internal Market," The Economist, 9 July 1988, pp. 6, 8.

department heads, are drawn from a pool nominated by the governments. Broader representative institutions have played only a fictive (or, more generously, a secondary) role. Moreover, decisions taken by the Council on major issues had to be unanimous, providing each government a veto. For this reason, it has been painfully difficult to extend the Community's authority; changing the rules of finance, or proceeding with the creation of a unified market and changing the rules of business in Europe have been painfully difficult. The most reluctant state prevailed. Furthermore, domestic groups could block Community action by persuading their government to exercise the veto.

Many see the Single European Act as the most important amendment to the Treaty of Rome since the latter was adopted in 1957.[30] This act replaced the treaty's original requirement that decisions be taken by unanimity with a qualified majority requirement for certain measures that have as their object the establishment and functioning of the internal market. The national veto still exists in other domains, but most of the 300 directives for 1992 can be adopted by qualified majority. As a result, disgruntled domestic interest groups have lost a source of leverage on their governments; the national veto no longer carries the clout it once did. Perhaps equally important, the Single European Act embodies a new strategy toward national standards that were an obstacle to trade within the Community. Previously, the EEC pinned its hopes on "harmonization," a process by which national governments would adopt "Euronorms" prepared by the Commission. The Single European Act instead adopts the principle affirmed in the famous Cassis de Dijon case. That principle holds that standards (for foodstuffs, safety, health, and so on) that prevail in one country must be recognized by the others as sufficient.

The third major actor in the story, besides the governments and the Commission, is the leadership of European multinational corporations. In some ways, they have experienced some of the consequences of the international economic changes most directly. They have acted both politically and in the market. The White Paper and the Single European Act gave the appearance of changes in the EC market that were irreversible and politically unstoppable. Businesses have been acting on that belief. Politically, they have taken up the banner of 1992, collaborating with the Commission and exerting substantial influence on their governments. The significance of the role of business, and of its collaboration with the Commission, must not be underestimated. European business and the Commission may be said to have together bypassed national governmental processes and shaped an agenda that compelled attention and action.

Substantial support for the initiatives from Brussels has come from the Roundtable of European Industrialists, an association of some of Europe's largest and most influential

30 This view is sometimes expressed in EEC materials lauding 1992. Not everyone would agree; they would cite budget initiatives in 1970 and 1975 and the direct election of the European parliament. We would cite the single European Act because it rejects the national veto.

corporations, including Philips, Siemens, Olivetti, GEC, Daimler Benz, Volvo, Fiat, Bosch, ASEA and Ciba-Geigy. Indeed, when Jacques Delors, prior to assuming the presidency of the Commission in 1985, began campaigning for the unified internal market, European industrialists were ahead of him. Wisse Dekker of Philips and Jacques Solvay of Belgium's Solvay chemical company, in particular, were vigorously arguing for unification of the EC's fragmented markets.[31] In the early 1980s, a booklet published by Philips proposed urgent action on the internal market. "There is really no choice," it argued, "and the only option left for the Community is to achieve the goals laid down in the Treaty of Rome. Only in this way can industry compete globally, by exploiting economies of scale, for what will then be the biggest home market in the world today: The European Community home market."[32]

It is hard, though, to judge whether the business community influenced Europe to pursue an internal market strategy or was itself constituted as a political interest group by Community action. Business began to organize in 1983 when the Roundtable of European Industrialists formed under the chairmanship of Pehr Gyllenhammer of Volvo. Many of the original business discussions included senior Community bureaucrats; in fact, Etienne Davignon reportedly recruited most of the members of the original group. The executives comprising the Roundtable (numbering 29 by mid-1987) were among the most powerful industrialists in Europe, including the non-EEC countries. The group initially published three reports: one on the need for development of a Europe-wide traffic infrastructure, one containing proposals for Europe's unemployment crisis, and one, Changing Scales, describing the economies of scale that would benefit European businesses in a truly unified market.[33]

The European Roundtable became a powerful lobby *vis-a-vis* the national governments.[34] One member of the Delors cabinet in Brussels has declared, "These men are very powerful and dynamic . . . when necessary they can ring up their own prime ministers and make their case."[35] Delors himself has said, "We count on business leaders for support."[36] Local and regional chambers of commerce have helped to establish about 50 European Information Centers to handle queries and publicize 1992.[37] In short, the 1992 process is

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31 "Europe's Internal Market," The Economist, 9 July 1988, Survey, p. 6.
32 Europe 1990 (Brussels: Chez Philips S.A., no date), p. 5, emphasis in the original.
33 Rob van Tulder and Gerd Junne, European Multinationals in Core Technologies (New York: John Wiley & Sons, 1988), pp. 214-15.
34 Based on interviews and discussions.
35 Quoted in van Tulder and Junne, Op. Cit., p. 215, fn. 8.
36 Axel Krause, "Many groups lobby on implementation of market plan," Europe, July/August 1988, p. 24.
37 Another business group collaborating with the Commission and actively promoting the 1992 process is the Union of Industrial and Employers' Confederations in Europe (UNICE) which includes over 30 industrial associations throughout Europe. The secretary-general of UNICE, Zygmunt Tyszkiewicz,

repeating the pattern established by ESPRIT: major businesses allied with the Commission to lobby governments that are already seeking to adapt to the changed international structure.

At the same time that the business community has supported the political initiatives behind the 1992 movement, it has been acting in the market place. A series of business deals, ventures and mergers form a critical part of the 1992 movement. Even if nothing more happens in the 1992 process, the face of business competition in Europe is being changed. The structure of competition is being altered.

There has been a huge surge in joint ventures, share-swapping, and mergers in Europe. Many are justified on the grounds of preparing for a unified market, some for reasons of production and marketing strategies, and some as a defense against takeovers.[38] But much of the movement is a response to business problems that would exist in any case. Still, the process has taken on a life of its own. The mergers provoke responses in the form of other business alliances; the responding alliances appear the more urgent because of the political rhetoric. As the Europeans join together, American and Japanese firms scurry to put their own alliances in place and to rearrange their activities.

A few examples will illustrate the nature of business choices and strategies that both respond to and reinforce the 1992 drive. An Italian entrepreneur, de Benedetti, tried to take over the Société Générale de Belgique. The Société Générale, though, is not simply another bank; it is an institution that played a vital role in the 19th century development of Belgium. The bank has its fingers in a substantial chunk of Belgian industry. The attempted foreign takeover was blocked by an alliance led by the French Bank of Suez with encouragement from the French government. The Société Générale de Belgique became a European development bank, controlled at once by Belgian, French, Italian, and British interests.

A second instance is the recent takeover of Plessey, a British telecommunications and electronics firm, by GEC of Britain and Siemens of Germany. The cross-national nature of the move is itself significant. The acquisition of Plessey by GEC alone had been blocked by the British monopolies commission in an earlier bid, but in the European context, the takeover proved acceptable. A third case is the merging of the semiconductor interests of the French firm Thomson with the Italian firm SGS. What was surprising was that it happened at the same time that Matra was backing out of the semiconductor business. In our view, French electronics is now entirely dependent on foreign sources for the final development and production of microelectronics, though French industry's ties within Europe have been strengthened. As a

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spoke of the group's working groups and lobbying: "Nine-tenths of our work comprises the regular, invisible interchange of ideas between our experts and the EC Commission's civil servants." Ibid.

38 See Craig Forman, "European Firms Hope Swapping Stakes Gives Them 1992 Poison-Pill Protection," Wall Street Journal, 18 October 1988, p. A26.

business deal it makes eminent sense and was a virtual necessity. That, however, has not always been decisive in French electronics policy. Whether the government simply acquiesced in management's choice or actively promoted the deal, the merger represents a real change in the government's attitude and policy: a European partnership is now acceptable in France. Finally, Asea of Sweden and Brown Boveri of Switzerland, two giants in the electrical generation business have merged. Swedes, and a Swedish chairman, are now managing the business from Zurich and implanting themselves in the United States through the purchase of elements of Westinghouse. In a direct response, Britain's GEC and Alsthom of the French CGE group have merged their power generation businesses.

Of course, one must not exaggerate. Deals linking European firms were roughly equal in number and value to those joining European to American enterprises. And the volume of mergers and acquisitions within the U.S. far outstripped that involving European firms. Still, the boom in intra-European mergers and alliances is a new development. The number of intra-EC mergers, joint ventures, and minority acquisitions involving the 1000 largest industrial companies in the Community jumped from about 50 in 1983-84 to 180 in 1987-88.[39]

These deals clearly represent decisions by major companies to join together on a European scale in order to position themselves for global competition. In many sectors, as Stephen Cohen points out, 1992 may consist fundamentally of these business alliances and mergers; that is, even if the process is limited to these alliances, big business in Europe will have been transformed. The business deals also represent a change in governmental attitudes to accept and encourage that process. While the pace of European mergers was accelerating in the mid-1980s, it became a rush in 1987. Perhaps not by accident, that was the year in which the political initiatives for a unified market became fully believable.

Open Trade and A Regional Economy?

The 1992 process may have been sparked by a change in the global system; its outcome is certain to shape both the structure and the regimes of the international system in the coming decades. The final shape of the deal that is emerging in Europe is not yet evident, but the new bargain -- resting on the White Paper, the Single European Act, and mergers and acquisitions -- does represent a sharp change from the first integration project. Recall our specification of the original construction, and note that each of its elements is changing. The internal market is being extended. National interventions are being limited and openly constrained by European institutions. The Commission is taking the political initiative in diverse areas from tax and regulatory policy through technology development. Direct foreign investment and joint

39 Michael Porter, "Europe's Companies After 1992," The Economist, 9 June 1990, p. 18.

ventures, not just trade, are forming the links among countries. The real issue here is whether the European Communities will pursue their objectives of a greater role in the world through projects and policies that go beyond the unified market. The vision of 1992 implies the need for future bargains -- both internal and external -- that are outside the formal 1992 process and its 300 technical measures. They consist of a diverse set of issues whose resolution will determine not only how complete the market unification is, but, more broadly, its character.

Some issues are purely internal. For example, the emergence of a single market pushed forward redistributive and social questions of substantial importance. The structural adjustment funds are the payoff from the richer north to the poorer south for its sustained participation in the project. An essential part of the bargain appears to be a massive increase in funds for the poorer regions, mostly in the south. The regional funds are scheduled to double in volume from 1988 to 1993. The estimates are that these funds will amount to as much as five percent of Greece's GNP and 1.5 percent of Spain's GNP.[40] Then there is the related problem of social Europe. Some fear that the very system of social protection and welfare that has become the cornerstone of political bargains in many of the European nations will be put in question. Even the business community is aware and concerned. As one conservative European business leader remarked, "One of the risks is in the social arena. If, in effect, we give in to the temptation to harmonize work conditions throughout Europe, all that we have succeeded in developing and modernizing will be put into question."[41] The EEC, as we noted, has generally set rules about business behavior. Except in agriculture, it has rarely directly affected outcomes or directly altered the welfare of specific groups in the society. A genuine internal market without restriction or subsidy will make social policy and tax rules appear, whether they do or not, to affect industry outcomes. Domestic social policy will become an issue of internal market negotiation. The shift of critical social issues to Brussels raised the question for some analysts of whether Europe 1992 was really a device for rightwing liberals and businesspeople to break the corporatist deals with labor that had been built in Europe over generations.[42] They see a pluralist lobby emerging in Brussels that will reduce the power of labor. Whether that fear is founded, the question remains of the balance between Community and national decision making. If Brussels begins to make substantial numbers of decisions with visible implications for people's lives, what mechanisms of political control will be established? The list of vital internal issues is long.

As the internal deals were being recast in Europe, those outside watched with concern. They wondered what the overall shape of the deal would be and how it would affect them. They

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40 Michael Emerson, "1992 as Economic News," unpublished essay, Brussels, 1 November 1988, p.5.
41 Francois Perigot, "L'Europe ardente obligation," Politique industrielle, no. 10 (Winter 1988).
42 Phillipe Schmitter, "A Revised Theory of Regional Integration," International Organization 24 (Autumn 1970).

asked whether Europe would move toward a unified and coherent position in the global economy. They speculated on what a unified European position would be; and on what sort of international economic order a new Europe would pursue. The concerns were real for, as a protagonist, Europe would be a major player.

The advanced countries will almost certainly become three trading regions organized around the United States, Japan, and the European Community. Europe as a relatively self-contained economic unit already exists. For nearly 20 years, Western Europe as a whole has represented roughly one quarter of global gross national product, (the European Community, over 20 percent), the United States roughly the same, and Japan about half the share of the U.S. or Europe.[43] As we showed in the first chapter, our understanding of the global trading system is radically different if we consider Europe as a single unit rather than the sum of its constituent elements. But should we do so? There are two competing images of Europe. One image presents Europe as a set of small and medium-sized countries that have opened themselves to the global economy and must adjust to it. If taken nation by nation (with trade within the region included) Western Europe in 1986 had 44.6 percent of global exports (up from 42.4 percent in 1967) and roughly 42.6 percent of global imports (down from 44.1 percent in 1967). France (26.8 percent) and Germany (32.1 percent) define one end while Belgium (87 percent) and the Netherlands (58.9 percent) represent the other, with Britain (41.2 percent) falling in between.[44] Thus, foreign trade (imports and exports) constitutes a large percentage of domestic product for each of the European countries.

The other image shows the European nations moving over the last thirty years from interlinked national economies to a regional economy. A self-contained economic region has already emerged. Europe's per capita imports from outside the region are, according to some sources, even lower than Japan's.[45] If we exclude intra-European trade (as we would trade between California and Michigan from American trade statistics), the picture changes. In that case, Europe represents 13.8 percent of global exports in 1986 (down from 15.3 percent in 1967) and 11 percent of global imports (down from 17.0 percent in 1967.[46] In this second view, the

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43 These conclusions are drawn from a map of global GDP developed by the BIPE and relabeled with their permission by BRIE. BIPE, the Bureau d'Information et de Prevision Economique, calculated these numbers from OECD figures. The map is in "La France dans l'Europe de 1993," BIPE, vol. 1, pp. 8 and 9. No publication date. This information is taken both from the Bureau d'Information et Prevision Economique, Europe in 1992 (Paris: BIPE, October 1987) and from Gerard Lafay and Colette Herzog with Loukas Stemitsiotis and Deniz Unal, Commerce International: La Fin Des Avantages Acquis (Paris: Economica, 1989) with figures taken from diverse charts and tables in section one.
44 Ibid.
45 Colette Herzog, "L'ouverture du marche europeen: une autre vision," Economie Prospective Internationale: Revue du CEPII, Premiere Trimestre 1988, pp. 81-89.
46 Lafay and Herzog, Op. Cit., from diverse charts and tables in section one.

countries of Europe are, together, no longer passive takers in the system; they are able to shape their international environment.

The new Europe, as Lafay and Herzog emphasize, lies between these two images. It consists of one tight bloc, the Community, and a looser confederation, the European Free Trade Association. Increasingly the EFTA is adjusting to recent EEC initiatives. Sweden has announced that it will apply for EC membership, and Norway and Finland may follow. What the mechanism may be -- from status quo through full membership -- does not much matter for the central argument here. The political boundaries are beginning to correspond to the existing pattern of economic and trade policies. This shift does not mean that Europe will become a fortress, but, in itself, the creation of a politically unified trade region, capable of coherent action, is significant. Europe will be concerned with itself. It does mean that Europe will now consciously develop joint policies to benefit the Community, policies in which internal considerations are primary.

Europe's choices will not be made in isolation. Europe's external policy takes will depend as much on choices made by its trading and financial partners as on its own predilections and internal politics. The structural shifts that compel European adjustments are also changing American and Japanese trade policies, changes that in their turn will alter Europe's choices.

The continuing process of a shifting economic order, American political choices and Japanese exports and investments, will set the context for Europe's decisions. American trade with Europe is quite balanced and, consequently, individual trade tensions can probably be managed within mutual commitments to open trade. However, the politics of American trade do suggest change, and real choices, for Europe. The most recent American trade bill represents a fundamental challenge to the intellectual premises on which policy has rested even while the implementation preserves, for the moment, the substance of U.S. policy. Since World War II, the United States has sought a world of increasingly open flows of goods and finance, but not of labor.[47] The principles of multilateral negotiation, extending to all countries concessions made

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47 The United States, at the moment of its economic and political dominance, structured the global trading system (as is so often repeated) around these principles and embedded them in its own legal practice. The reality, of course, has been more complicated. It has involved a series of exception to these principles. One set of these exceptions, made from a position of economic strength, was made for foreign policy objectives. The United States -- at least in its conception -- opened its market to Japan, the developing economies, and Europe and tolerated trade discrimination. The second set of exceptions, made from a position of sectoral weakness, has involved bilateral bargains to contain imports in specific sectors: autos, textiles, steel. Those sectoral bargains were often made to accommodate those who would challenge the general principles of trade policy. Importantly, the level of imports that triggers substantial protectionism has been quite high. The delicate hypocrisy has been more difficult to maintain as the coalition in support of open trade has narrowed. The balance between principles of multilateralism and a reality of bilateralism has slowly tilted toward bilateralism as a growing number of sectors have achieved protection, and, in the years of the deficit, that tilt has become more pronounced.

to one, encouraged a focus on rules that would promote the general welfare. "Reciprocal" concessions were required from all parties; reciprocity implied rules for the game, not specifications of the score. Put differently, the U.S. sought to promote market processes and to avoid bargains about outcomes; the reciprocity was "generalized" reciprocity.[48] The new intellectual frame includes the notion of specific reciprocity: that trade is fair when the outcomes are balanced, and that outcomes -- not process -- are the core of discussion.

Specific reciprocity emerges in two contexts. In the broadest context, it tries to place the burden for the American trade deficit on the countries with trade surpluses, on the premise that limits to American exports and subsidy of foreign product are the core of the problem. Of course, those national policies to which the U.S. now objects were in place during the thirty-plus years in which this country dominated trade. A somewhat narrower context is in telecommunications, the notion being that closed markets in Japan alter the dynamics of competition in advanced technology. The American policy debate thus pushes a new kind of reciprocity (and a debate about outcomes) onto the negotiating table.

Will Pressure From Japan Shape The External Bargains[49]

By contrast, the competitive pressure from Japan will continue to determine many of the trade choices Europe must make. Those choices must, almost inevitably, determine whether, or in what way, Europe becomes an economic region turned in on itself -- a fortress. Europeans, focused on their own commitments to maintain an open trade system, sometimes ignore the fact that intense competitive pressure from Japan and Asia in a series of domains may produce an outcome that they themselves do not want. Americans, one must acknowledge, often are so focused on the European response to these pressures that they underestimate Europe's commitment to open trade.

A long list can be made of Euro/Japanese trade conflicts, each involving a different type of problem that could affect the character of the European project. When Willy de Clerq was External Relations Commissioner, his call for reciprocity in financial relations set off a great furor. The policy was aimed at opening access to Japanese financial markets for European firms or at least limiting a flood of powerful Japanese banks into Europe, but it hit most directly the interests of American financial institutions. Charges of dumping brought by the Community against copiers produced by Japanese firms in the United States forced the questions both of what entry strategies Europe would accept from Japanese firms and what indeed constituted a Japanese product. Remedies that specified local European content also hit U.S. companies by

48 For the difference between general and specific reciprocity see Jagdish Bhagwati, Protectionism (Cambridge, MA: MIT press, 1988).
49 This section is drawn from...

forcing the Japanese copier companies to design out U.S. manufactured components. The current debate on Japanese auto quotas in Europe may determine how extensive the trade protectionism that Europe adopts to limit Japanese market penetration will be, while the use of industrial standards to maintain markets becomes evident in the discussion of High Definition Television (HDTV). One European senior executive when asked how many HDTV standards there would be remarked that there would be as many standards as were required to keep the Japanese out of Europe. However a detailed look at any of these questions --- reciprocity, dumping, quotas, standards -- would not identify the central dynamic, which is the enormous competitive challenge from Japan.

Japan's industrial success is built on real production breakthroughs and organizational innovations which present exceptional problems for established European firms. The extraordinary profitability of the Japanese firms and the considerable export surpluses that have resulted from that industrial competitive advantage give Japanese firms and financial institutions considerable financial muscle. That financial strength permits Japanese firms to implant themselves in European markets; the production strength will help them succeed.

While Japanese firms in a broad range of industries are strong in global markets, it is in volume consumer durables such as automobiles and consumer electronics that quite unique advantages have been established. The effective introduction of "flexible automation" or a "lean production system" by many, but not all, Japanese firms, has given them absolute advantages of cost, quality, and new product development.[50] It is not simply that, for example, the best Japanese auto companies produce cars less expensively. It is not simply that quality is higher as measured by defects or fit and finish. Higher quality cars can be produced less expensively. Equally, product cycles are shorter; the time from design idea to showroom floor is quicker. This translates into a capacity to respond to market shifts and introduce technological innovation at a faster pace. The result is that not only are volume car companies such as Volkswagen, Fiat, and Renault vulnerable; rather, even the top end specialists, such as BMW and Mercedes, have few automatic defenses against this surge. The same market pressure exists in eonsumer electronics from VCR's, compact disc players, radios, fax machines, to telephone terminal equipment. Certainly, we do not mean to exaggerate by emphasis. Design and innovation advantages from computer architectures through anti-lock brakes provide competitive advantages for European and American firms. In chemicals and machine tools, for example, Japanese firms are strong but not globally dominant. Yet the advantages they already hold mean

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50 James Womack, et. al., The Machine that Changed the World (New York: Macmillan Publishing, 1990). Seminal work on the notion of "lean" production. They attribute the phrase to one of their colleagues, John Krafcik.

that established firms in European and American markets lose position, and when market share is lost to imports, jobs are lost as well.

Equally important, as chapter 1 argued, high volume consumer durables are increasingly becoming the driving force behind technological innovation in advanced technology. High volume, high-technology is a crucial new category. High volume electronic products are increasingly driving a broad range of underlying component technologies including semi-conductors, opto-electronics, precision mechanical and magneto components and displays, and power supplies. Control of these technologies is critical to all electronics production. In automobiles, similarly, electronic engine management, anti-lock braking systems, and communications technology make electronic auto component firms sources of profound technological innovation. In our view, for example, two of the most sophisticated electronics firms in Europe, Intermetall and Bosch, produce for the consumer electronics and automobile markets and are not counted among traditional lists of European firms.

The basic questions here are not the source or extent of Japanese direct foreign investment, but the character of the European response. First, how much room will Europe provide for Japanese firms? The specific debate in the news is about the length and extent of protection for European automobile producers, but the general principle is whether the pace of Japanese entry will be contained by trade policy. Second, what will be the form, and who will be the agent, of public support for the adjustment of European firms? Precisely because the Commission is trying to uproot state subsidy to national firms, trade protection is all the more probable -- despite protestations to the contrary. Third, what Japanese development policies and corporate entry strategies will Europe accept? Here we find the question of dumping restrictions, insistence on local production, and demands for entry to the Japanese market.

There is no single European answer to these questions. There is certainly no common position among the governments, nor, for that matter is there a single view within the several departments in the Commission. The range of views among the countries is extreme. The Italians and French have sought in autos and consumer electronics to restrict severely Japanese access to the European market. The precise instruments and policy disputes are adapted to that general purpose. The British, by sharp contrast, see Japanese implants as a mechanism to rebuild Britain's manufacturing base. This is not simply a matter of investment, but of reorganizing production and introducing new notions of how labor and management can operate. Other national views fall between on this spectrum, varying degrees of toleration of open competition depending on the basic competitive position of the nation's industries. Thus, German opposition to the auto quotas reflected the small but highly profitable position of Mercedes and BMW in Japan and the confidence of these companies that they can hold their European market. But the position is reported to have shifted shortly after a careful evaluation of the Lexus (Toyota) and

Infiniti (Nissan) entries in the luxury market that, along with Honda's NSX in the high performance market, provide a real challenge to Europe's leading niche producers. (For those who doubt this, note the October issue of Car and Driver that rates the 4 leading sedans at any price. The Lexus 400 made the list at No.3, at roughly 1/2 to 1/4 the price of the others) Similarly the range of views within the EEC Commission is wide. Consider the notion of a developmental strategy for European electronics really represented by the position of DG XIII. That view is substantially challenged by DG IV (Competition) which has gained influence and will continue to seek to wrestle power away from both the rest of the EEC bureaucracy and from the member states.

While for now there may be no single policy strategy or view, there may be an outcome generated from the initial mix of policies. That initial outcome, we would propose, is forcing direct foreign investment and local production. That is, Japanese firms will be ceded market share more easily when that share comes from production within Europe, rather than from imports. The view rests explicitly on four assumptions, each of which is plausible, but may be seriously mistaken. First, and centrally, is the notion that if firms are implanted in Europe they can be controlled, influenced or instructed by national governments and the Commission. On matters of plant location or employment policy this may be the case, but on matters of technology development and diffusion it is much less certain. Second, production in Europe will at least limit employment loss. For many purposes -- wages and taxes among them -- employment in a Japanese plant in Europe is as good as in a European owned plant and not all that different from employment in an American owned plant. However, the real levels of employment may be radically reduced if new, more efficient production organization is introduced and European industries restructure. Third, European producers contend that if Japanese companies operated under European social rules and union environments they would lose their vaunted production edge. However, Japanese firms operating in Europe and the United States are able to achieve productivity and quality rates well above those of local competitors even though they do not match performances that they achieve in Japan. Therefore, forcing transplants may not put the Japanese at a disadvantage.

Finally, it is proposed that if local content rules and high tariffs on components and subsystems compel the sourcing of parts in Europe, then European producers will hold onto much of the value added in products even if final assembly moves to Japanese hands. Unfortunately, the American experience suggests strongly that local suppliers will have considerable difficulty fitting into Japanese systems and, often, meeting Japanese standards. The result will be that the final product assemblers will pull their Japanese suppliers with them into Europe. This raises the central question of how Japanese entry will affect the supply base and development trajectory of Europe. The industrial supply base consists of the set of producers of components, materials, and production equipment. It represents an infrastructure of skills, know-how, and technology. That infrastructure is the base on which next generation product and process must be built. It contains the capacity to adjust to shifts in the pattern of market demand. Although many elements of necessary supply are available on global markets, the capacity of firms in one region to adapt in a timely fashion does seem to turn on the locally available knowledge and skills. Customers are able to compel appropriate access, price, and quality from local suppliers far more directly than they can from remote suppliers. This is a particular problem because producers -- as Japanese suppliers -- are linked to the industrial families of the major Japanese auto and electronics firms that compete in Europe

Thus, the open question is whether the entrance of Japanese suppliers brings to Europe new techniques and technologies that then diffuse more broadly into the fabric of the European economy, or whether those suppliers control technology access, price and quality to the advantage of their major Japanese customers. The outcome, not deducible from analytic premises, turns on which activities are moved to Europe and how product and technology development in Japan is linked to European activities. The advanced electronics segment of the European supply base is the most vulnerable element because it is simultaneously Europe's weakness and Japan's perceived greatest strategic advantage. The recent announcement by Toshiba of new battery technology for portable computer applications from one of its suppliers, and Toshiba's unwillingness to disclose the supplier or permit access to the technology, are suggestive of the potential leverage at stake. These concerns, we would note, are explicitly articulated in recent European Commission policy positions agreed to amongst directorates.

Undoubtedly, Europe's industrial position is strong despite the years of supposed sclerosis and Japanese ascent. The strengths continue to lie in volume production, though the Japanese challenge is now emerging in traditional sectors such as textiles, and production equipment in general. European firms have been very effective at applying advanced technology; often they have been at the forefront in developing products embedding advanced technology. But they have been less effective at maintaining a market position in a range of the advanced electronic products from semiconductors through computers. The visible weakness lies in advanced technology, but when that category is disaggregated there is one fundamental weakness -- advanced electronics. The series of joint research efforts, including Esprit, Race, and Prometheus, are clearly advanced electronics technology programs developed in response to this perceived weakness.

With Fujitsu's takeover of ICL, the problem of the European electronics base is reopened. In one sense, the sale simply reemphasizes the market weakness of most of Europe's computer firms; apart from Siemens, neither Olivetti, Bull, nor Philips is in a fundamentally sounder position. It also highlights the fact that the European computer firms are dangerously close to being nothing more than distributors for Japanese producers due to critical weaknesses in their internal product portfolios. However, the ICL takeover is more than a symbol. Since joint European R&D programs were set up as a response to the European weakness there has been a resistance to American participation. Some American firms that both produce and engage in R&D in Europe have joined some EC programs. Now, of course, the question becomes whether these institutional rubrics can support the effort of Europe to create a technological response to Japan. The same logic that led Sematech to exclude all foreign companies from its efforts in the U.S. -- the perceived need to keep the Japanese out -- is posed here in Europe.

The European technology support programs are being built at the same time that an effort is being made to dismantle programs of state subsidy to domestic producers. The decisions to compel IRI's subsidiary, Finemeccanica, to reorder the books of the sale of Alfa Romeo to Fiat is but one instance in a series of such decisions. National subsidy has often served as an alternative to formal trade restrictions. It is a floating and indirect tariff, but one which avoids formally redefining the character of the trade relations. Will formal bilateral restrictions on trade be more likely in the absence of domestic subsidy? We suspect so.

This leaves one final issue: the Japanese developmental system and the Japanese market for imports. As has the United States, Europe is responding to Japanese entry with concerns over both the strategy of Japanese government support to help create advantage in global markets and of restrictions on exports to Japan. Japanese policy, by contrast, has moved from a language of restriction in a developmental strategy toward a language of liberalism. The reality has been a loosening of the developmental system, but, in our view, not its abandonment.[51] Markets have been formally opened, primarily where Japan has an established advantage in global markets. However, in sectors where advantage is yet to be established or where Japanese firms have lost the advantage, a band of protectionism still remains. Barriers remain both in policy and business practice. Their significance lies in several domains. First, in emerging or transforming sectors: If one powerful national player maintains a closed domestic market, its firms gain substantial competitive leverage. Second, if the United States is not able or willing to absorb the world's exports, will Japan do so? Third, if barriers of access to financial markets are maintained, then Japan gains leverage in global financial and product markets. Japanese financial institutions can then use their role in intermediating the massive Japanese savings to entrench themselves in the financial markets of the United States and Europe. Politicians, as divided on other matters as Rocard and Thatcher, have nonetheless argued powerfully that only Japan's restraint in its use of policy and pricing to create advantage and its acceleration in

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51 Laura Tyson and John Zysman, "Developmental Strategy and Production Innovation in Japan," in Chalmers Johnson, Laura Tyson and John Zysman, eds., Politics and Productivity (Cambridge, Mass.: Ballinger, 1989).

opening domestic markets can hold back pressures for European retaliation. Europe's stance *vis-a-vis* Japanese entry will, in the end, be influenced by its own success in Japanese markets.

The Second Phase: Redefining Europe

These American and Japanese developments press on Europe questions that it must resolve in any case -- those of reciprocity and outcomes on the one hand, and the choice between free market or developmental policies on the other. The notion of general reciprocity in trade bargains, which focuses on maintaining market processes, gives way to specific reciprocity which focuses on specific outcomes. Most concretely, there are manufacturing sectors where national restrictions must either be abandoned or generalized to Europe. The real challenge to national producers is not, for the most part, other European or American producers, but Japanese producers. Consequently, in a range of products from automobiles to dot-matrix printers, the question becomes the terms on which the European market will be available to Japan. For instance, at present, anti-dumping rules are applied to restrict imported printers and photocopiers. In automobiles, the question is whether Europe should exact a price for opening the French and Italian automobile market to Japanese competition. At this writing, the French have agreed to treat Japanese car production within Britain as European, but the argument hardly seems over. Policies are pressing toward requiring direct foreign investment in components and assembly; the largest surge in new investment will come from Japanese manufacturers. Indeed, 1992 is accelerating Japanese entry into the European automobile market.

America initially reacted nervously to the 1992 project, fearing a "fortress Europe" that would shut out American products. Events have mostly allayed those fears because the Community has not engaged in the wholesale construction of barriers. Americans have relaxed because protectionist measures in Europe have frequently been directed against Japanese goods, especially electronics and automobiles. Engaged in their own contentious trade disputes with Japan, Americans may be more likely to sympathize with the Europeans than with the Japanese. Still, Europe's newfound assertiveness and cohesion on market matters will make it a formidable player in international trade. Free trade areas are under discussion in North America and in Asia. In their public rhetoric at least, supporters of the proposed free trade areas assert the need to respond to Europe 1992.

Europe will be an international protagonist in trade, but in what kind of role? Will the EC promote principles of free trade, or espouse developmental policies to justify protection? Clearly the answers depend both on the positions taken by Europe's major partners, and on a complex chain of bargains among EC members. As the Commission cracks down on government subsidies to industry, some states will try to turn to trade restrictions as an alternative. The initial outcome seems to be the creation of incentives for foreign (especially

Japanese) producers to locate within the Community. The deadlock in the Uruguay Round of GATT negotiations creates the danger that expanding free trade may take second place in Europe to preserving politically privileged economic programs.

The European project will, then, for the second time in a decade, be sparked by a change in the international system. Europe is pressed another step toward the role of protagonist on the global stage. The retreat of Soviet power from Eastern Europe will force a redefinition of Europe, both of who is in a community of democratic, market-oriented European nations and what the relations between them will be. Whether or not the Cold War is truly over (a live question given the increasing trauma inside the Soviet Union), the direct military threat to Western Europe is reduced. This alters the European security problem and inevitably brings a reconsideration of Europe's fundamental interests. Inevitably, both security and the place of military defense must be reconceived.[52] Whereas the first phase, recasting EC bargains, was a response to essentially economic challenges, the second phase entails a redefinition both of the Community itself and its place in the world.

The revolutions in Eastern Europe, welcome as they were, brought in their wake three major challenges to Community institutions and roles. First, stability in the central European corridor of Poland, Czechoslovakia, Hungary and Yugoslavia suddenly became an issue for the EC. The Community had an immediate stake in the economic and political development of Eastern Europe not least because of the possibility of sudden and massive migrations should reforms fail. But in the longer term, those same countries were virtually certain to become EC members. Second, the waning of the Cold War removed one key obstacle to membership applications from the European Free Trade Association. Already fearing exclusion from the EC's internal market project, EFTA countries could actively pursue membership in the EC once Europe was no longer the fulcrum of Cold War balancing. Austria has already applied, Sweden has announced its intention to do so, and Norway may follow. The prospect of new members from EFTA and from the East called into question the viability of Community institutions: If joint decision making was difficult for 12, it would be impossible for 18 or 20. EC institutions would have to be reformed in order to prevent obstructionism and deadlock. "Deepening" the existing Community, both by integrating in new areas (monetary, foreign policy) and by reforming institutions, became the Commission's priority, argued explicitly and repeatedly by Jacques Delors.

The third major challenge driving the redefinition of Europe was unified Germany. German unification raised the same issues that Eastern Europe and EFTA did, only in more

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52 Admiral Sir James Eberle, Director, The Royal Institute of International Affairs, 12 December 1990, Valedictory Address.

immediate form. A consensus rapidly emerged among Germany, its EC partners, and the Commission that the new and enlarged Germany had to be integrated more tightly than ever in an expanded web of Community ties. Thus, the movements for economic union and political (foreign policy) cooperation accelerated as German unification proceeded. Indeed, monetary union is, above all, a political objective -- not an economic necessity. Its importance merits closer analysis.

The fusing of Germany's two halves in 1990 revived questions that had been dormant as long as the Cold War standoff froze Europe's economic, political, and security frontiers. The European Community anchored part of Germany in the West. German unification, in the context of a general Soviet withdrawal from Eastern Europe, gave rise to multiple uncertainties and questions about Germany's ties. Some worried that Germany would weaken its links to the West, either as part of a package negotiated with the Soviets or as a response to opportunities for economic and political leadership to the east. In late 1989, in fact, some observers speculated that Germany would no longer perceive a need for the Community. Another set of concerns focused on the weight that an enlarged Germany would carry in Europe. West Germany had been the region's strongest economic power; a unified Germany might become a hegemon in Europe. It would have ever greater power to shape the regional economic environment.

Monetary union had been on the EC agenda since the 1969 summit at The Hague. It received only indirect mention in the Single European Act, but took on new impetus as the 1992 project forged ahead. With German reunification, the Commission and Community members (especially France) redoubled their effort on behalf of economic and monetary union (EMU). Germany and its partners endorsed EMU as a means to build on the single market project, avert German preoccupation with its own problems, and avoid German domination of the European economy. EMU would both bind Germany into a Community central banking system (and possibly a single currency) and dilute Bundesbank control of joint monetary policy.

The impetus for EMU is thus clearly political. Indeed, there have always been open disagreements about the economic benefits and details of EMU. Though presented by Jacques Delors as the necessary and natural extension of the single market project, the economic logic is at best cloudy. Professional economists offer widely divergent assessments of the economic wisdom of monetary union in Europe. Unlike in the cases of free trade and factor mobility, there is no unequivocal answer to the question of whether permanently fixed exchange rates or a single currency is required by a single market[53]. Certainly, the elimination of capital controls in

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53 The analysis which follows was undertaken with Costas Tsatsaronis. see Giavazzi, F, and Giovannini 1989 Limiting Exchange Rate Flexibility chpt. 4 MIT press, Giavazzi, F 1989 The exchange rate question in Europe in Macro Economic Policies in an Interdependent World IMF, De Grauwe, P 1989 Is the EMS

Europe could generate capital flows that might not be manageable within the existing exchange rate system.[54] The assumption is that German monetary policy restricted the options of other countries, unless they resorted to capital controls. Removing capital controls, the logic runs, will amplify pressures on exchange rates. This logic is not unchallenged and the gains from an EMU not unequivocal. Eichengreen, reasoning from the American experience, contends that an EMU would be difficult to sustain unless Community budget transfers are sufficient to offset market shocks within a single economic community. The Community budget is a much smaller percentage of Community GNP than the Federal Budget is of American GNP. Absent a real economic compulsion or political necessity, formal models suggest that the incentives for countries to participate are very weak.[55] Or, more precisely, the economic incentives are only convergent if small countries have proportionally more influence than larger ones in the decisions of the central bank. Reaching an equilibrium distribution of power is therefore very difficult. The details of this and other models are not crucial. What does matter is that there is both a substantial difference in judgment about the gains and problems of an EMU, and real political obstacles to solving the problem of adherence and governance. We have not even opened the question that an EMU would require a significant loss of national policy autonomy to achieve any economic gains. Moreover, of importance in a moment, the bulk of the debate is about the efficient and stable operation of the European market. There is no automatic or natural economic process or pressure that will lead to an easy adoption of EMU.

The movement toward EMU must therefore be seen as a political solution to problems other than the internal ones of the single market or financial liberalization. EMU became an effort by Germany and its neighbors to strengthen and expand the web of Community ties. Furthermore, for Germany's partners, EMU would dilute Germany's preeminence in Europe. If, as many argue, the EMS is really a D-mark zone run by the Bundesbank, then the EMU is an effort by the other countries to have a seat at that monetary table. Thus German unification mobilized interests that pointed toward an enhanced, not a reduced, role for the European Community.[56] Germany had two overarching motives for fortifying its EC ties in the wake of unification. First, the EC market remains crucial to the German economy, accounting for over half of German exports and imports. Second, German leaders wanted to banish even the hint

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a DM Zone CEPR Discussion Paper, 1990 "Asymmetry in the EMS Intentional or Systemic" European Economic Review Vol. 33.

54 Eichengren, B. 1990 One Money for Europe? Lessons from the U.S. Currency Union Economic Policy No 9 April, London.

55 Casella, A 1990 Participation in a Currency Union CEPR Working Paper and Casella, A and Feinstein J 1989 Managing a common Currency in A European Central Bank Cambridge University Press

56 See Wayne Sandholtz, "The EC and the East: Integration After the Revolutions of 1989," Dialogue: a magazine of international affairs 2 (Summer 1990), pp. 12-16.

that Germany would try to forge an autonomous path as hegemon in a newly configured Europe. They wanted to demonstrate that the enlarged Federal Republic would remain a committed participant in Western (especially European) institutions. Chancellor Kohl repeatedly emphasized that Germany's agenda was unification within the context of European integration.

By the same token, Germany's EC neighbors had powerful motives to ensure that Germany would stay a member of the club. On the economic side, the German market was a crucial part of the common market; the share of total exports flowing to Germany ranged from a low of about 11 percent for Ireland and Spain to highs of 27 and 31 percent for the Netherlands and Greece, respectively.[57] Most of the EC countries had tried their currencies to the Deutschemark in the EMS, benefitting from its anti-flationary powers. On the political side, the more Germany was integrated into common institutions, the more secure its partners would feel. As it became clear that German unification was inevitable, President Mitterand began pushing for increased EC integration, from monetary union to common security policy. Denmark, so often among the most reluctant of partners, displayed a sudden enthusiasm for strengthening the Community.

In short, both Germany and the other EC states had powerful interest not only in continued German commitment to the Community but in expanding the number and nature of EC commitments. The growing consensus on the need for strengthening the Community found concrete expression in parallel intergovernmental conferences convened in December 1990, one to pursue monetary union and the other to chart the course toward political union. Both projects reveal a European Community trying to redefine itself and its role in the world.

Of course, EMU was already on the EC agenda when German unification became an issue. The Commission had been promoting the idea as the 1992 project pushed ahead. The French endorsed the notion, calling in January 1988 for a European central bank. Thus the interest in monetary union did grow out of the experience with the EMS and the drive for completing the internal market. Monetary union would compete the former and complement the latter. But the political changes in Eastern Europe -- and thus in Germany -- gave EMU a decisive new impetus.

As revolution added to revolution in Eastern Europe during 1989, Commission President Jacques Delors repeatedly argued that progress on "deepening" the Community, through monetary union and political reforms, was becoming increasingly urgent. The EC summit at Madrid in June 1989 committed the Community to beginning stage one of the Delors plan for monetary integration in July 1990, and called for the preparation of the measures needed to

57 Derived from Statistical Office of the European Communities, Basic Statistics of the Community, 27th edition (Luxembourg: Office for Official publications of the European Communities, 1990), pp. 270, 272.

proceed to monetary union.[58] President Mitterrand and his ministers echoed Delors; in fact, by October, Mitterrand was calling for early discussions on monetary union, asserting that the changes in Eastern Europe meant that the EC "should accelerate its own construction."[59] In early November, to the world's amazement, the Berlin Wall tumbled down. Mitterand went on a tour of European capitals to drum up support for his proposal for speedy progress on monetary integration.[60] Kohl firmly endorsed French proposals to push ahead on political and economic union. Later that month, Chancellor Kohl announced his ten point plan for German federation, dramatically raising the tempo. Meeting at the Strasbourg summit in December, EC leaders endorsed the idea of German unification "in a context of European integration" -- a link that Kohl and Foreign Minister Genscher were at pains to reiterate. The Strasbourg summit, not coincidentally, also called for an intergovernmental conference on monetary union to be convened before the end of 1990,. The heads of state declared that the conference would draft articles on monetary union, which should be ratified by December 1992. In the wake of German developments, the monetary timetable became substantially more concrete and ambitious.

The two halves of Germany agreed early in the spring of 1990 on their own economic and monetary union (GEMU), to take effect on 1 July. Some observers, noting that GEMU would entail a fiscal drain on the West and thus exert pressure on the Deutschemark, speculated that Germany would be less interested in monetary union at the EC level. Again, events had the opposite effect. By February 1990, Jacques Delors was calling for institutional reforms (greater powers for the European Parliament, increased majority voting in the Council) and for EC foreign policy. Following the March elections in Germany (electing a Christian Democrat-led government in the east), French Foreign Minister Roland Dumas called for quickening the process of monetary integration and moving on toward political union. In May, Kohl and Mitterrand issued a joint communiqué calling for political union, to begin in 1993. The member states strongly endorsed both monetary and political union; only the British were viscerally opposed to both.

At the Dublin summit in June 1990, the EC heads of state voted to convene the two intergovernmental conferences in December. The conference on monetary union would prepare treaty revisions, to be ratified by the end of 1992. The British found themselves in the anomalous position of voting (reluctantly) for EMU discussions while not participating in the

58 Stage one includes participation in the EMS exchange-rate mechanism by all Community currencies; removal of restriction on private use of the ECU; a common financial market; enhanced economic and fiscal policy convergence; and increased monetary policy coordination.
59 David Buchan, "Mitterrand urges early talks on EC monetary integration," Financial Times, 26 October 1989, p.1.
60 Laura Raun, "Dutch back Mitterrrand's plan to accelerate EMU," Financial Times, 21 November 1989, p. 2.

exchange rate mechanism of the EMS. The tension inherent in that anomaly helped bring about British membership in the exchange rate mechanism (in October 1990). At the Rome summit in October, Thatcher was more isolated that ever, as the other eleven countries voted to begin the transitional stage two of the Delors plan in January 1993. Thatcher also dissented from the list of topics the other eleven agreed should be discussed at the intergovernmental conference on political cooperation. Thatcher's recalcitrance on EC issues contributed to her downfall less than a month later.[61]

The conference on monetary union convened in December 1990 as scheduled. Many divisive issues remain unresolved. But the unification of Germany, in the context of Soviet retreat from Eastern Europe, gave political urgency to the process. Monetary union is not simply part of the single market program or a logical extension off the EMS. It is part of Europe's redefinition of itself.

Finally, the implications of the Monetary Union in Europe extend beyond the borders of the Community, and the potential gains for the Community depend on the position that it will assume in the international scene. That in turn will depend on the weight of the EMU in international negotiations and institutions and on the effects of a European currency, the ECU, on the world financial markets. Certainly the EMU would give Europe enormous weight in both negotiations and institutions. Europe voting as a bloc with current quotas would have greater power in the IMF than the U.S. and Japan combined. Moreover, it would obtain -- along with the U.S. -- an effective veto, even if its quotas were reduced by excluding intra-community trade. Equally important, influence and profit could come to the Europeans by an extensive role of a common currency in world monetary markets.[62] The EMU, and its implications for internal efficiency, cannot be separated from its external role in defining Europe's place in an emerging international financial order in which the dollar may not be the only international money, or international money at all.

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61 The final blow may have been Sir Geoffrey Howe's dramatic resignation from the cabinet. In his speech to Parliament, Howe included a blistering criticism of Thatcher's stubborn opposition to increased European integration in monetary and political affairs.

62 The rate of its acceptance would not be a political choice, but European countries would use fewer dollars to intervene in exchange rate markets and there would be at least some demand for an ECU by third country central banks for intervention purposes. Private sector acceptance of the currency would turn on the ease of transactions. Crucially, to the extent that the ECU will be successful in replacing the dollar as a world currency it will allow the EC to claim profits from international seignorage, the right to create money, by virtue of the fact that a European central bank will be able to issue debt denominated assets of which it controls the supply. Such seignorage becomes a non-budget means of providing a central authority with the equivalent of transfer payments to hold a monetary union together. European authorities are clearly aware of this and have begun to discuss the problems of seignorage in a reconstructed international monetary order in major Community documents.

Indeed, in money and trade it does appear that the outcome of phase one, recasting the bargain, and phase two, redefining Europe, makes it probable Europe will emerge as a protagonist. But what about the security and political realm?

Europe as Protagonist? Resetting Europe's Place

Europe's adjustment to the retreat of Soviet power has already begun to alter its very definition and purposes. On many issues, the alternative to a collective European action will be simple national squabbling, leaving Europe a taker of choices made elsewhere. Some see the war in the Persian Gulf as a harbinger: the United States set the tone and direction of policy, and European governments faced the choice of going along or not. The answer will not be so simple as a single federal executive, but rather a complex pattern in which Europe is likely to find a common position rapidly enough to shape choice on some matters, but not is not able to do so on others. Again, our view is that the real incentive or pressure to generate mechanisms for common European action comes from the change in the global system. The system shift is two fold. First, Europe's security position will not in the future be as closely aligned with the United States. The corridor of former Soviet satellites between Western Europe and Russia reduces the military danger of overrun; the Soviet concern with its own internal difficulties reduces the security threat. But existing security structures in Europe are premised on that threat, and American involvement on the continent defined by a common interest in the face of an aggressive Soviet Union. NATO members agreed to maintain the organization, but the significant fact is that its future existence was up for discussion.

Second, the real dangers to the European nations come in different forms and different places. Instability in that corridor running from Poland through Yugoslavia, to be intensified if there is a dissolution of the Soviet Union itself, will generate problems that only begin with people fleeing from economic dislocation or even from civil war. That instability will be principally a European problem; America has more or less opted out of a role in shaping developments in these regions. Political turbulence in North Africa and the Gulf pose not only a threat to oil supplies, but of migration and increased political activism from minority Muslim citizens. The United States has displayed little understanding or sensitivity to these problems, and in any case our common security framework is largely irrelevant to them.

The renewed call by Mitterand and Kohl in the winter of 1990 for acceleration of discussions of political union, initially voiced in the spring of 1990, came as a response to the European inability to shape events in the Gulf, a region that affects Europe in such varied ways. Cooperation on foreign and security policies is on the agenda for the intergovernmental conference opened in December 1990. Those discussions will begin from common foundations in trade and money, and emerging technological collaboration in civilian and military domains.[63] Talks presently focus on the West European Union (WEU) as a venue for Europe-level defense policies, leaving open the possibility that the WEU could be drawn into the EC institutional fold at a later stage. Though tough negotiations are ahead, both President Mitterand and Prime Minister Major emphasized in June 1991 that current differences must not deflect the Community from its eventual goal. The range for joint political maneuver will grow, both as Europe senses the extent of its collective resources and confronts the consequences of American withdrawal from leadership in areas such as Central Europe. For the United States the dominant question is whether a single European -- or at least Community -- defense posture is established such that Europe renegotiates its defense alliance with the United States.

Whether or not the Atlantic alliance undergoes formal revision, security ties between the United States and Europe are certain to change. Some of NATO's functions may go the way of old soldiers -- they may simply fade away. Europe will redefine its security interests and arrangements. An EC security arm will not emerge fully formed, as a political construction. Rather, the political and defense architecture will be built in response to a series of crises and demands, each posing the need for common action. In the meantime, the intertwining of economic and security matters will produce gradual, piecemeal changes in Europe's security identity.

For instance, high technology development overlaps military and commercial sectors. At one level, high-tech defense industries are becoming less national and more regional. Cross-border joint projects are already the norm for aircraft, helicopters, and missiles. Networks of alliances link GEC, British Aerospace, MBB, and Aérospatiale. Recent transnational mergers and acquisitions have further integrated the European defense industry. Siemens and GEC purchased Plessey in 1989. GEC and Daimler-Benz (a major defense firm since its purchase of Dornier, MTU, AEG, and MBB) each hold a stake in Matra. As William Walker and Philp Gummett have argued, such links will create headaches for policy-makers, especially since the major defense firms are also the largest commercial enterprises in aerospace, electronics, and communications. National and EC officials in charge of safeguarding industrial competition will therefore face new challenges in the form of giant cross-national consortia active in both defense and commercial markets. National defense procurement agencies will face the same few broad industry groups, who will therefore have a greater say in which defense systems are to be produced, across Europe. Walker and Gummett make the case that de facto industrial integration

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63 **Bonnie Gold**

could lead to pressures for increased cooperation in procurement decisions, which, in turn, require closer coordinating of defense strategies and force postures.[64]

The 1992 project for the internal market could overlap with procurement issues. Already in place is EC legislation that will open public procurement markets in the previously restricted sectors: transport, telecommunications, water, and electricity. The military will remain one of the largest sectors for government purchases. As liberalization in other state-dominated markets delivers real savings, pressure could mount to provide the same economies in defense procurement. The drive to open public purchasing to competition could carry over to the defense sector; an EC-wide defense procurement market would provide incentives to coordinate decisions on missions and force composition.

European collaboration in high-technology R&D could also provide an avenue for increased security cooperation. Community programs like ESPRIT and RACE have produced solid, though unspectacular, results in microelectronics, computers, and communications technologies. Participants generally regard such programs as well-run and worthwhile. The EUREKA program, with over $6 billion worth of joint projects, initially had an ambiguous orientation. Though its French proponents stressed that it would be a civilian program, the technological areas they outlined for EUREKA exactly paralleled those being pursued in the U.S. Strategic Defense Initiative.[65] To the extent that the boundary between advanced commercial and defense technologies has blurred, such programs may support (or could easily be adapted to support) a European technology base for both civilian and defense applications. Such programs could also provide an organizational model for collaborative defense R&D programs in the future.

In short, Europe faces drastically altered security challenges. The Soviet-American Cold War faceoff no longer dominates European security. The Warsaw Pact dismantled itself, and a buffer of independent (but west-leaning) states emerged between Western Europe and the Soviet Union. At the same time, a European Community with renewed vigor and self-confidence seeks both to solidify its integrative ties and extend them to new areas. As a result, formerly axiomatic definitions of European security are thrown open to question. The new answers will include a more unified, self-consciously European defense presence linked, in the long term, to the European Community.

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64 William Walker and Philip Gummett, "Britain and the European armaments market," International Affairs (Summer 1989), 435-42.
65 See Sandholtz, High Tech Europe, chaps. 7, 8, and 9.

Conclusion:

Europe wrestles with shifts in the international system and with a drastic reconfiguration of its own political landscape. Both the distribution of capabilities and the nature of threats (economic and security) are shifting dramatically. We hypothesize that in the first phase change in the international economic system was necessary (though not sufficient) for the initial revival of the European project in the form of 1992 (recasting the EC bargain). We also hypothesize that its intensification and extension into the monetary and possibly political arenas were responses to seismic shifts in the political foundations of post-war Europe, namely, German unification and Soviet withdrawal from Eastern Europe. The sudden enlargement of Germany and the prospect of new applicants from Eastern Europe and EFTA accelerated Community efforts to strengthen EC institutions and pursue monetary integration, a process we called "redefining Europe." The dissolution of the Soviet bloc altered the security context for Europe. In response, Europe is resetting its international position by seeking to define security interests and institutions that will be more autonomously European. The Community is already a major international protagonist in trade, and may become one in monetary affairs.

A full-fledged test of these propositions will require detailed analysis of the perceptions and beliefs of those who participated in launching the 1992 movement and its follow-ons. Certainly the available political histories support these propositions. Structural situations create the context of choice and cast up problems to be resolved, but they do not dictate the decisions and strategies. Changes in an existing distribution of capability and of threat may undermine a particular alliance system, but the alliance system that emerges is a reflection of the perceptions of threat and of the conceptions of how to respond.

In other words, the global setting can be described superficially in neo-realist fashion, but the political processes triggered by changes in the system must be analyzed and explained in other than structural terms. The choices result from political processes and have political explanations. In this case, the process was initially one of bargains among nations and elites within the region. "Europe 1992," the EMU and a European political presence form a complex web of bargains and accommodations, the key ones being among the national governments, but also involving business elites. Furthermore, EC institutions have, at various stages, shaped the agenda, accelerated the negotiations, and guided the bargaining. The outcomes are quite unknowable, dependent on the timing and dynamics of a long series of contingent decisions. But the story, and consequently the analysis, concerns political leadership in creating a common European interest and then constructing a set of bargains that embody that understanding. Many of the choices are simply calculated risks, or perhaps explorations that will be entrenched if they work and refashioned if they don't.

The details may not be possible to foresee, but no one should underestimate Europe's formidable capabilities. Even in an area of perceived weakness like high-technology, Europe's clear problems (weakness in components and computers and the resulting dependence on the U.S. and Japan) mislead. In militarily relevant high-technologies -- including aerospace, nuclear energy, advanced materials, transportation, and communications -- Europe has major strengths. Airbus has passed McDonnell-Douglass to become the second largest aircraft producer, with a third of the world market. Advanced battlefield communication technology for the U.S. Army comes from Thompson. In high-speed trains, Europe is a leader. In any case, Europe's choices, particularly those that increase the possibility of a coherent Western Europe emerging as an actor on the global stage, will powerfully influence both the world economic and security systems.