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A PRIMER ON THE EUROPEAN COMMUNITY

INTRODUCTION

The European Community (EC)[1] is now the world's largest commercial and trading unit, with twelve countries, 320 million people, an annual gross domestic product in 1988 of over $4 trillion, exports of $680 billion, and imports of $720 billion. Removal of the remaining internal EC barriers to the movement of goods, services, capital, and labor in 1992 should strengthen further the EC's already strong economic position. The economic issues EC integration raises for the United States are inseparable from those other Europe-related crucial issues like the future of the North Atlantic Treaty Organization and the Warsaw Pact, the reunification of Germany, and the need for radical economic reform in Eastern Europe.

The EC currently is far from being a unitary, sovereign "United States of Europe." It is more than an alliance or collection of twelve separate states. This hybrid construct makes it difficult for American lawmakers to understand what the EC is, how it works, and how its development may affect North America. The changing nature of the EC as it moves toward integration adds to the confusion. If American policy makers are to conduct relations with the EC that best promote U.S. interests, they must try to understand the nature of the institutions of the EC.

1 Although commonly called the European Community, the alliance's formal name is the European Communities. It consists of the European Economic Community, the European Coal and Steel Community, and the European Atomic Community. The term "European Economic Community" often is used incorrectly to describe the whole.

This is the first in a series of Heritage Foundation studies on the European Community. Future studies will examine economic and security aspects of Europe's 1992 integration.

Dozen Members. Established in 1958, the Community originally consisted of six members: Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands; in 1973, Britain, Denmark, and Ireland joined. Greece became a member in 1981 while Portugal and Spain were admitted in 1986. The principal decision-making body of the EC is the Council of Ministers, consisting of the foreign ministers of the member countries and, twice a year, of the Heads of Government. Until 1987 the Council could act only if all members concurred. Now decisions can be made with less than unanimity.

The EC Commission, based in Brussels, is similar to the Executive Branch of the U.S. government. It administers EC policy and has a great deal of latitude in its exercise of power through rule making. The Presidency of the Commission, with a term of four years, is currently held by Jacques Delors of France. It is the EC's most powerful single office.

The European Parliament, elected by popular vote similar to that sending members to the U.S. House of Representatives, currently only advises the Commission and Council, although in certain situations it can veto some measures, such as the EC budget. The influence of this Parliament, however, is growing.

Political Tensions. A number of current issues will determine EC evolution. A key question is how much power EC institutions will have to influence or even to manage the European economy. Britain and some other member countries fear that the EC might seek to overregulate businesses and impose socialist policies on the member states. This has provoked political tensions and could undermine some of the economic benefits of integration or produce a publicly weaker Europe.

Another set of problems is posed by the revolutions in Eastern Europe. Investment funds that probably would have flowed from wealthier to poorer parts of the EC might now go to Eastern Europe instead. This significantly could affect the future politics, as well as the economic development, of the EC. American and Japanese investment funds bound for the EC similarly might be diverted to Eastern Europe.

German reunification poses another deep concern. West Germany has the strongest economy in Europe. In the short run large West German expenditures to cover the costs of integration with East Germany could slow the German economy, and with it the economies of the rest of the EC. In the long term, the economy of a united Germany could dominate the EC. This prospect makes other EC members nervous, and may encourage moves to weaken EC institutions to avoid German control.

THE INSTITUTIONS OF THE EC

After World War II the democratic countries of Western Europe sought closer economic ties as a means to resist the Soviet threat and to promote economic recovery. The Common Market, now usually called the European Community (EC), came into existence on January 1, 1958. Initially there were six member countries: Belgium, France, West Germany, Italy, Luxembourg and the Netherlands. The initial goal was to remove trade barriers between the member countries.

Today, with twelve members the EC has a common set of tariffs for all imports from non-EC countries. The EC plans by the end of 1992 to remove the remaining barriers to the movement of goods, services, capital and labor, to create a true unitary market.

At first the legal structure of the EC resembled a set of treaties between sovereign nations. Then, over the years, the Community created institutions, independent of the member governments, that have decision-making powers over EC affairs. Advocates of a strong EC feel that these Community institutions should not be limited to deciding only trade and other economic matters, but ultimately should form the heart of a political union as well – in essence, a United States of Europe. Others, most notably British Prime Minister Margaret Thatcher, resist the loss of national sovereignty that would result from political union, and argue that the Community should concentrate on achieving a free and open economy. Much of this debate concerning the future evolution of the EC will revolve around the powers of the various institutions of the EC.

1) The Council of Ministers

The principal decision-making body of the EC is the Council of Ministers, composed of the Foreign Ministers from each member state. The Council deals with issues involving the broad nature and structure of the EC itself, laying down guidelines and providing political direction for the Community's other institutions. The Council, for example, has resolved such issues as the proposed admission of new member countries and the direct election of representatives to the European Parliament, and is debating the establishment of a European Monetary Union.

The Council meets in Brussels twice each year. Depending on the subject at hand, Ministers of Agriculture, Trade, Economic and Financial Affairs, Social and Cultural Affairs, Industry, among others, sit alongside their respective Foreign Ministers at Council meetings. The Council Presidency rotates every six months. The Council President chairs the meetings, but has few real powers.

Twice yearly the Heads of Government of the member countries and the Commission President join the Foreign Ministers. These meetings are known as the European Council. This Council deals with Community matters and is the primary forum for resolving the most basic difficulties and disagreements between the member states. Example: The European Council plans to discuss the future political integration of Europe at its December 1990 meeting.

Weighted Voting. Until the passage by the Council itself of the Single European Act in 1987, all Council decisions had to be unanimous to bind member states. Now decisions are based primarily on weighted voting. Approval of a resolution requires 54 of the Council's 76 votes, with Britain, France, West Germany, and Italy each having ten votes; Spain having eight; Belgium, Greece, Netherlands, and Portugal each having five; Denmark and Ireland each having three; and Luxembourg having two. This so-called "qualified majority" of 54 prevents an alliance of the four largest powers from forcing decisions on the smaller powers, and prevents any single country from exercising a veto. Only an absolute majority, or 39 votes, is required to reject or amend any resolution.

The abandonment of the requirement for unanimity in the Council of Ministers is a crucial step toward European integration. The unanimity rule made Council decisions more like treaties between sovereign countries, since any country could block a change in EC rules. Under the "qualified majority" system, by contrast, member countries are bound to accept decisions with which they may not agree.

A Court of Auditors and the Committee of Permanent Representatives help the Council prepare for meetings by gathering background information on issues and by arranging the agendas. The auditors appointed by the Council, have extensive powers to verify the legality and regularity of community revenues and expenditures. The Committee consists of the ambassadors of the member states to the European Community.

2) The Commission

Similar to the U.S. Executive Branch, the Commission initiates policy by drafting regulations (known as directives) and legislation for consideration by the Council of Ministers. The Commission also executes the policy decisions once the Council has acted. Day-to-day EC operations are run by the Commission. Again like the U.S. Executive Branch, the Commission is intended to be the advocate of Community-wide interests as distinct from the national interests of member states, which usually are emphasized in the Council of Ministers and the European Council.

The governing body of the Commission consists of seventeen Commissioners, appointed to four-year, renewable terms. Britain, France, Germany, Italy, and Spain, the five largest nations, each select two Commissioners, while the smaller nations each appoint one. Every Commissioner is supported by his or her own "cabinet." The Commission is organized into 22 "directorates-general" (DG), with each responsible for executing policy in its areas of responsibility (see Table 1)

The Commission is headed by a president, currently Jacques Delors of France whose four-year term was renewed for two additional years in January 1989. The Commission Presidency probably is the EC's most powerful position. Delors has been especially active in pushing for expanded scope and powers of the EC.

3) The European Parliament

The European Parliament was created as the Community's "watchdog." Initially it had little power. Changes in its method of election, its responsibilities, and the increasing sophistication of its members, however, has been transforming it into a significant power center. The Parliament's main task is to monitor the work of the Council and the Commission, and it must be consulted by the Council prior to any final decision. The Parliament has the power to re-allocate, increase, or reject any Commission request for discretionary spending. It can veto Commission directives relating directly to the operations of the European market. For non-economic matters, however, it generally functions as an advisory body, rather than as a legislative assembly.

The Parliament is composed of 518 members elected directly for five-year terms by the citizens of the member countries. In this way it is similar to the U.S. House of Representatives. The most recent election was in June 1989. The size of each

Table 1

The Commission's Directorates-General

#1	**External Relations**	Develops and distributes information and conducts relations with non-EC countries and other institutions.
#2	**Economic and Financial Affairs**	Develops specific economic policies to implement EC directives.
#3	**Internal Market and Industrial Affairs task force; small- and medium-sized enterprises**	Oversees the single market process and sets guidelines.
#4	**Competition**	Sets anti-trust laws and ensures competitive forces within the EC.
#5	**Employment, Social Affairs, and Education**	Develops and administers social policies.
#6	**Agriculture**	Develops and administers agricultural policies.
#7	**Transportation**	Develops and administers transportation policies.
#8	**Development**	Develops and administers foreign assistance policies; in accordance with the Lome Convention on development between the EC and less-developed countries.
#9	**Personnel and Administration**	Keeps personnel records and handles administrative tasks.
#10	**Information, Communication, and Culture**	Funds cultural activities.
#11	**Environment, Consumer Protection, and Nuclear Safety**	Sets environmental standards and administers policies.
#12	**Science, Research and Development, and the Joint Research Centre**	Plans and monitors scientific research and development projects.
#13	**Telecommunications, Information Industries, and Innovation**	Sets and administers standards for telecommunications.
#14	**Fisheries**	Controls fisheries industries.
#15	**Financial Institutions and Company Law**	Oversees banking policy and regulations concerning corporations.
#16	**Regional Policy**	Plans and administers regional development.
#17	**Energy**	Sets and administers energy policy.
#18	**Credits and Investments**	Handles securities and exchange policies.
#19	**Budgets**	Develops EC budgets.
#20	**Financial Control**	Maintains financial systems.
#21	**Customs Union and Indirect Taxation**	Administers trade policies and directs collection of tariffs.
#22	**Coordination of Structural Instruments**	Coordinating body within EC that oversees internal structural functions.

country's delegation is determined by the country's population. Because members are elected directly, each delegation tends to reflect the political parties and factions of its country. Because of this, alliances of members within the Parliament mirror not only national interests but also political philosophies that cross national boundaries. A socialist member from France, for example, may have more in common with a German socialist member than with a conservative French member. The Parliament meets in Strasbourg, France, although there is growing pressure to move it to Brussels.

Although its role is primarily advisory, the Parliament has an important function in reviewing Commission directives. In this review procedure:

♦ ♦ Draft directives from the Commission are reviewed by one of eighteen parliamentary committees devoted to specific substantive categories, such as trade, finance, and agriculture. The committee can recommend that a draft be accepted, rejected, or modified.

♦ ♦ The Council then considers the Commission directive in light of the Parliament's opinion, and adopts what is known as a "common position." This need not reflect the Parliament's position. Approving the Commission draft requires the "qualified majority" of the Council. To modify the draft, the Council vote must be unanimous.

♦ ♦ The Council's decision must be submitted to the Parliament, which has three months to take one of three actions.

1) **It can adopt** the Council's "common position," either by taking no action or by endorsing it with a simple majority vote. The proposal then goes back to the Commission. A qualified majority at the Commission can make the proposal official EC policy.

2) **It can amend** the "common position" with an absolute majority. In this case, the draft goes back to the Commission and to the Council for approval.

3) **It can reject** the proposal with an absolute majority. In this case, the proposal dies. By this, the Parliament exercises an effective veto.

THE GROWING POWER OF PARLIAMENT

The Parliament does have the power to veto certain draft directives and supplemental appropriations. Except for these, the Council and the Commission can accept or reject the Parliament's views. In recent years, however, these EC institutions increasingly have come to respect the Parliament's suggested changes in Commission drafts. Since members of Parliament are popularly elected, they carry the weight of the European public.

Example: The Commission in late 1988 voted to ban sales of beef treated with artificial growth hormones; this would hit imports from the U.S. The Parliament, under pressure from environmentalists and local producers, decided that the Commission had not gone far enough. The Parliament thus rejected the Commission draft for a limited ban on beef treated with artificial hormones and proposed instead a ban on beef treated with either artificial or natural hormones. The Council and Commission acceded to this decision.

The Parliament's growing influence is likely to attract the lobbying efforts of a number of labor unions, consumer advocates, environmentalists, and other political and special interests. As the Parliament's political power grows, it probably increasingly will use its power over the budgetary process for greater control over EC policy.

The Court Of Justice of the European Community

Acting as the EC's supreme court of appeal, the Court of Justice of the European Community interprets treaties, laws, and directives. The Court, meeting in Luxembourg, decides on legal disputes between or among member states, between Community institutions and member states, between Community institutions themselves, and between private companies or individuals and the Community. The Court's thirteen justices are appointed by the Council of Ministers for six-year terms. There is one justice from each member country plus a chief justice. Decisions of the Court require a simple majority vote.

The Court's importance has been growing. As the Council and Commission make decisions concerning economic integration, many questions and disputes arise. In these situations the Court is often the final arbiter.

THE BUDGET

The EC budget for 1990 is 46.7 billion European currency units (ECUs), a measure based on an average of the various member country currencies. This is equal to about $55 billion, and represents around one percent of the combined gross domestic products (GDP) of the twelve member states.

Initially the EC was financed by government contributions based mainly on GDP of each member state. In 1970, the Community established its own sources of revenue and abandoned the system of contribution. A 1988 agreement placed a ceiling on the EC budget of 1.2 percent of Community GDP.

Major revenue sources for the Community's general budget include:

♦ ♦ Customs duties on imports from non-member countries;

♦ ♦ Special levies on agricultural imports;

♦ ♦ A 1.4 percent portion of the value-added tax collected in each member country with a ceiling on the amount a country must pay based on each country's GDP.

Unlike the budgets of most international organizations, the Community budget is devoted mostly to operational expenses. Administrative costs take up only about 5 percent of the total. More than 90 percent of the budget is devoted to economic, social, and regional expenditures in member countries and in less developed countries. Apart from spending on agricultural guarantees and a few other projects, most spending is conducted on a shared-cost basis, with the Community

Table 2

1990 EC Budget Allocation

	European Currency Units (billions)	Percent of Budget
Agriculture: Including price supports and payments for surplus commodities.	29.53	63.2
Regional Policy: Includes funds for development of poorer areas of the EC.	5.21	11.2
Social Policy	3.67	7.9
Repayments andReserves	2.35	5.0
Research, Energy, and Industry	1.76	3.8
The Commission: Mainly administrative costs.	1.51	3.2
Cooperation with Developing and Non-EC Countries: Mainly foreign aid and support for trade and investment.	1.45	3.1
Other EC Institutions	.85	1.8
Fisheries	.38	.8
TOTAL	**46.71**	**100.0**

subsidizing programs submitted by member states or public or private bodies. Based on the 1988 reforms, the Community introduced tighter budgetary procedures. The budget allocations of the 1990 EC budget are shown in Table 2.

Control of the budget is shared between the Council and the Parliament. Each year the Commission drafts a preliminary budget which goes to the Council for amendments and approval by the qualified majority of 54 of the Council's 76 votes. The Council's draft budget is then debated by the Parliament. Typically, some three-fourths of a budget consists of spending required by treaty obligations, over which Parliament has little to say. The Parliament can propose modifications for the remainder of the budget. But even here the Commission can set ceilings on spending increases. The amended budget then is returned. If the Parliament proposes increases in expenditures, the Council must approve with a qualified majority. If the Council does not accept changes recommended by Parliament, the Parliament may reject the entire budget. This has been politically unpalatable. In practice, therefore, the Council has primary control over the budget.

THE CHALLENGES OF INTEGRATION

Between now and 1992 the EC will face a number of issues concerning the final scope and structure of an integrated Community and its relations with Eastern Europe and the rest of the world. These complex issues will be dealt with in part through the existing EC institutions. Many of the decisions will affect the role of these same institutions.

Perhaps the most important question facing the EC is what role its governing institutions should play in the domestic economic policies of the member countries. The British, for example, are concerned that Brussels will end up playing the role of a central economic planner, reintroducing into Britain the type of socialist policies that Prime Minister Margaret Thatcher has been dismantling during her decade in office. The British and others fear that in general the bureaucrats working for the Commission will become more powerful and intrude increasingly into the local affairs of each member state.

Common Currency Problems. A number of proposals reflect such concerns over the future structure and powers of EC institutions. One of the most important involves the proposal for a common European currency, with monetary decisions removed from the individual member governments and given to a centralized EC banking institution. Critics of a strong EC, like Britain, fear that this would give Brussels too much power and remove an important check to abuses of authority by the central EC government.

Another proposal raising similar concerns about sovereignty is the French socialist government's support for a number of policies that together are known as "social charter." This would make the Commission in Brussels a kind of international social welfare state, or, as French Premier Michel Rocard describes it, the "European model of social organization." This charter could have wide repercussions. For example, it would force EC businesses to accept worker participation in company decision-making.

Danger for U.S. An EC with expanded, centralized powers, would pose a twofold danger for the U.S. First, the European economy could stagnate if it is subjected to even more of the regulations that already impede the region's economic growth; a stagnant Europe is a poor customer for American goods. Second, protectionism and other obstacles to imports from the U.S. almost surely would result from government efforts to "preserve" the jobs of local workers.

Competition For Investment

The integration process has focused attention on economic relations and differences between the more industrialized northern EC members and the more agricultural members of the south – Greece, Italy, Portugal, and Spain. Integration, it is assumed, will lead to faster economic development in the poorer regions and a more competitive Europe. Without barriers to trade and capital flows, investment dollars likely will move south to take advantage of less expensive labor, spurring economic growth in the south while forcing industries in the north to become more efficient and competitive.

But the promise of expanding markets and a freer economy in Eastern Europe now pose a threat to the southern EC members by providing an alternative investment opportunity for the EC's richer states. Eastern European governments already are offering extremely attractive joint venture and investment opportunities for European firms. The West Germans especially are taking of advantage of these offers. As it becomes more difficult for Southern European countries to compete for northern investment dollars, they no doubt will push within the EC for measures to tilt the balance more in their direction.

Investment Incentives. This could have important implications for the U.S. and Japan. Each of the EC countries currently has an incentive program to attract international capital investments. For example, France offers grants of up to 25 percent of an investment for an industrial facility located in rural areas of the country. Britain finances up to 25 percent of costs of certain research and development projects. Ireland offers international companies a low 10 percent corporate tax rate until the year 2000. And Spain offers financing packages of up to 75 percent for construction or acquisition of a plant in certain declining industrial zones.

So far, these incentives have helped draw American businesses into the EC. For example, American Telephone and Telegraph Co. has established a joint venture in Italy with Italtel S.p.A. and in Denmark with Noriske Kabel-og Traadfabrikker. Caterpillar Inc. has expanded its operations to Belgium. The Coca-Cola Company, Arco Chemical Company, and Allied-Signal, Inc. each have expanded into France.

But Eastern Europe potentially could draw U.S. and Japanese investments away from the EC. This could cause the Community to reevaluate its investment and development policies.

A Unified Germany

The prospect of German reunification raises a number of questions concerning the 1992 integration initiatives. In one sense East Germany is already a member of the EC. West Germany long has treated imports from East Germany as if they were domestic products, without tariff or most other trade restrictions. German reunification will expand this to all of the EC, allowing free flow of East German labor, capital, and goods to the EC.

There is anxiety among the other EC members that West Germany henceforth will be devoting more of its resources and attention to East Germany and less to the EC. If, as it seems likely, the cost of the reunification slows West German economic growth, it could spell problems for the EC. With West Germany as the economic engine of Europe, if its market slows, the rest of the EC would suffer.

A related worry is the eventual economic and political strength of a unified Germany. With West Germany already the predominant power in the EC, the 78.4 million population and $1.350 trillion GDP of a unified Germany (compared to a $702 billion GDP and 57.1 million population for Britain and a $949 billion GDP and 55.9 million population for France) could make the EC a very lopsided organization. Other EC members may try to strengthen the Commission and the Parliament as a means to tie Germany to the Community and to rein in its burgeoning power. It is also possible that just the opposite strategy might emerge. Member countries could seek instead to hold on to national power and prerogatives rather than surrender them to the Commission and the Parliament, to avoid German domination of Europe through the EC's institutions.

AMERICAN RELATIONS WITH THE EC

As the EC has moved toward economic integration, the U.S. government has begun to focus more on the Community as a unit. Among the U.S. government agencies dealing with the EC:

The Office of the U.S. Trade Representative (USTR). The USTR handles the majority of contacts with the EC, most of which involve trade negotiations and disputes. For example, the EC restricted imports of U.S. wheat in 1987 as part of its agreement allowing Spain and Portugal to join the Community. The USTR negotiated compensation from the EC to make up for lost U.S. sales. The USTR also follows EC issues that relate to American businesses and works to assure that new barriers are not erected to U.S. exports. The USTR, for example, has worked to assure that the process of setting manufacturing and commercial standards for the integrated EC is open or "visible" so that American firms can offer input.

The Department of Commerce. Within the Commerce Department is a Single Internal Market: 1992 Information Service, part of the Office of European Affairs. This Service provides information to American enterprises seeking to do business in the EC.

The Interagency Task Force on EC 1992. This Task Force within the U.S. Executive Branch includes members from most cabinet-level departments. It also includes participants from agencies that have some interest in the EC, for example, the Customs and Immigration Service, Council of Economic Advisors, Office of Management and Budget, the Environmental Protection Agency, and the Small Business Administration. The Task Force provides a forum for these departments and agencies to exchange information and discuss policy matters concerning EC 1992.

The U.S. Mission to the EC. Just as the U.S. has ambassadors in most world capitals, it has one specifically assigned to EC headquarters in Brussels. America's Ambassador to the EC, currently Thomas Niles, and his staff at the U.S. Consulate General help coordinate the U.S. relations with the EC and work closely with the USTR.

Private Sector Presence. Private American businesses and interest groups have a special opportunity to take advantage of the growing power of the EC Commission. Americans have considerable practice in dealing with and lobbying the sort of bureaucracies now found in Brussels. Most Europeans do not have this lobbying experience. Already American businesses such as International Business Machines, Apple Computers and the Pharmaceutical Manufacturer's Association have offices in Brussels and are actively watching out for their interests. The International Freedom Foundation, an American-based think tank, has an office in Brussels to promote a free market approach to EC-1992. American businesses and interests would do well to consider opening offices is Brussels.

CONCLUSION

The final form that the EC will take on after 1992 is still very much an open question. Currently it is far from being a "United States of Europe." It is, however, much more than a treaty between fully sovereign independent nations. Much of the struggle over the future shape of the Community will come down to decisions concerning what powers the EC institutions will have. American decision makers thus should watch the development of these EC institutions very carefully.

Toward an Open Economy. An EC with an intrusive central government which overregulates the economy would, in the end, be economically weak. This would place a serious drag on the world economy and limit an important market for American exports. It could also add mean increased trade protectionism. Similarly, the situation in Eastern Europe could have a significant effect on the EC's attitude to the U.S. Fear in the EC that Eastern Europe might lure away potential investment funds might well encourage the EC to be a more open, less regulated economy. And an EC that is a true free market will be economically strong, benefitting both the economic and security interests of the U.S.

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