Europe’s Euro Future

by David Talvast

Europe has been working hard to become a powerful trading block. To this end, the member states of the European Union have made many changes, none more important than the adoption of a common currency, the Euro. This change will be historic and monumental. And it’s coming sooner than you think. The Euro will have major repercussions for American exporters and U.S. companies.

In order to clearly understand the rapidly changing European Union, consider the time line at right.

Why Does Europe Want a Common Currency?

The European Union favors a common currency primarily because it offers price stability and fiscal strength. The Euro will take on many of the positive features of the U.S. dollar. Better control of public deficits will permit the Euro to become a strong reserve currency. A strong Euro should also help to keep interest-rates low. Lower interest rates and the size of this new market will help increase capital inflow investment into the member countries.

The paramount mission of the new and independent European Central Bank will be to preserve price stability throughout the monetary and economic markets. Within the European Monetary Union (EMU), companies will enjoy more transparent markets, which will allow for more aggressive, competitive pricing. This competition will create a dynamism in the Euro arena that will give European firms a stronger competitive position in foreign markets.

Over time, the Euro will become less sensitive to exchange rate fluctuations. As national currencies fade from prominence and the Euro becomes fully integrated, the effects of exchange-rate fluctuations caused by non-Euro currencies will have a less dramatic impact on Europe.

Another important factor for European companies is that the single currency will offer them competitive financing as a result of the increased competition among banks and financial companies. Most U.S. banks that deal in foreign currencies are already set up to handle the Euro and are ready to work with matters related to this new currency. According to local bankers, U.S. banks do not expect profound changes in the way transactions will be managed as a result of the move to the Euro.

European exporters and importers will also have less exposure to foreign exchange risk, and, therefore, fewer requirements for risk insurance as they convert to invoicing in the Euro. This will help the Euro become widely accepted as an international currency and a payment tool, like the U.S. dollar today.

This new European market will create heightened demand for high-tech products and services such as Internet technology and computer software. The new transparency in the European Union will release pent-up

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demand for new technology in the member state’s
domestic markets. For example, last September, some
French hypermarkets recorded a turnover growth of
60% in their computer departments. Europe will see
greater demand for transportation (planes, automobiles,
trains, trucks), because travel will become more
intensive in Europe and goods will move throughout
Europe much faster.

This giant market is a good opportunity for U.S.
products and services as Europeans learn to do business
in a huge, open market like that of the United States.
Today most European small businesses still trade
primarily in regional markets.

The New Europe: A Giant Market

The introduction of the Euro will effectively create
a region as large as the United States and bigger than
Japan. From the table below, we can see how strong the
European Union has become. The European Union’s
Gross Domestic Product (GDP) is 38.3 percent of the
GDP of the entire industrialized world (i.e. those
countries belonging to the Organization for Economic
Cooperation and Development). The U.S. is second with
32.5 percent, while Japan is a distant 20.5 percent.
Excluding intra-EU trade, the European Union accounts
for 20.9 percent of world trade, as compared to 19.6
percent for the United States and 10.5 percent for Japan.
Europe will be a major source of world growth into the
next century.

According to the European Union’s Web page,
http://europa.eu.int, the “degree of openness” of an
economy can be measured by its share of exports as a
percentage of GDP. For the European Union today, this
figure is 29.8 percent, while the United States’ export
percentage of GDP is only 8.2 percent, and Japan’s is 9
percent. If intra-community trade is excluded, the E.U.’s
degree of openness is still higher at 10.2 percent of GDP.
In short, Europeans trade.

These comparisons reinforce the fact that Europe is
a giant market. Further reduction of tariff and non-tariff
trade barriers will open up greater opportunities for
commerce in Europe. A unified Europe will be a source
of dynamism not only for the European Union member
states, but also for the United States.

Europe and the U.S.

The future relationship between Europe and the
United States is likely to focus on a common goal:
creating a world partnership. The four objectives of this
partnership will be:

- Promoting world peace and stability
- Creating a global economy
- Democracy
- Global economic development

The E.U.-U.S. relationship is essential for both sides, as
three million employees depend on the two-way trade
and investment. In 1994, these bilateral transatlantic
investments represented 395.5 billion dollars and
supported three million jobs (the Europa Web site
http://europa.eu.int/pol/ext/fr/info.htm). Using these
figures, one can calculate that 100,000 jobs are
supported with every 13.18 billion dollars of investment.
This equals one new job for every U.S. $131,833 in
investment.

The Challenges Ahead

During the transition period, Europe will likely
experience some disruption as unstable exchange rates
are produced by excess dollar reserves. The European
short-term response will likely center on strict exchange
policy and an increase in interest rates. This will affect
capital inflows, creating pressure on the exchange rate
of the Euro. The challenge for the European Central
Bank and the economic policies of the member
countries will be to anticipate this short period of
instability and preserve price stability.

Europe will experience other problems within the
transition period, such as accountancy problems for
companies doing business in, and with, Europe. They
will need new computer software, and not every one will
switch to the Euro at the same time. Fiscal difficulties
will affect all players, including governments, exporters,
importers, accountants, and brokers.

Nevertheless, the new Europe represents a very
good opportunity for U.S. firms to increase their sales
without a lot of risk. Opportunities will exist in
technological markets such as software, the Internet
commerce, medical equipment, transportation, and
communication systems. The time to get into Europe is
NOW. Committing to the European common market
during this transition period presents the best
opportunity for gaining a strong foothold in this
dynamic economy.

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International Development Group. He is here on a merit
scholarship from the Technical University Institute in
France.

<table>
<thead>
<tr>
<th>Population (in millions)</th>
<th>Share of OECD GDP (%)</th>
<th>Share of World Trade (%)</th>
<th>Export GDP Ratio (%)</th>
<th>Foreign Exchange Reserves (in billion $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>263</td>
<td>32.5</td>
<td>9.6</td>
<td>49.1</td>
</tr>
<tr>
<td>Japan</td>
<td>125</td>
<td>20.5</td>
<td>0.5</td>
<td>172.4</td>
</tr>
<tr>
<td>EU</td>
<td>370</td>
<td>38.3</td>
<td>0.9*</td>
<td>349.8</td>
</tr>
</tbody>
</table>

* Excluding intra-EU trade
**Source: IMF
Tennessee’s Booming Mexican Market: A Hidden Success Story

Contrary to what we sometimes hear, the international news is not all bad for Tennessee. Lost amidst all the gloom and doom over Asia is a second, far brighter story: a remarkable surge in this state’s exports to Mexico. Tennessee sales to Mexico increased by an astonishing two-thirds last quarter. At $285.6 million, this constituted more than 11 percent of all state exports. Only sales to Canada have ever reached such levels, absolutely or relatively. In 1997 annual state exports were up 44 percent over 1996, and they were 56 percent higher than in 1994, the year before the peso crisis. For most of the 1990s, Mexico vied with Japan as the state’s second largest market. But after this recent explosion, Mexico has pulled far ahead, with its 1997 purchases of Tennessee goods exceeding Japan’s by some $200 million. It is clearly now behind only Canada as a trading partner for Tennessee.

The climb in exports is occurring across a wide spectrum of industries and products. In 18 of the 39 Harmonized Tariff System-coded industries in which Tennessee exports to Mexico exceed a million dollars a year, sales have doubled since 1995. Among major industries, only pulp products and some textile goods have not been expanding their sales. What’s going on? Certainly there has been a rebound effect as Mexico recovers from the last big international crisis, the peso collapse of 1994. But exports are by now in the range of 50 percent higher than before Mexico’s ensuing recession, so we are not just looking at a brief catch-up effect. A better long-term explanation is NAFTA. While it’s too early for NAFTA to be taking all the credit, it clearly deserves some. A significant liberalization of Mexican trade and foreign investment practices has assisted not only sales to Mexico, but also the integration of production across the two countries. But we should remember that the integration of the American and Mexican markets has been an ongoing process, which NAFTA just confirmed as much as any other agreement.

The increasing cross-border integration of production best explains the magnitude of the rise in the state’s exports to Mexico.

A significant liberalization of Mexican trade and foreign investment practices has assisted not only sales to Mexico, but also the integration of production across the two countries.

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initiated. And indeed, in the end it is the increasing cross-border integration of production that best explains the magnitude of the rise in the state’s exports to Mexico. The increases in exports, though occurring for many products, are concentrated in several areas, especially the textile and apparel industry and the automotive sector. These are sectors where the manufacture of the final good often proceeds in steps spanning both sides of the border. We have seen in previous issues of *Global Commerce* that the automobile industry dominates Tennessee-Mexico trade. Automotive-related exports (cars, trucks, and their parts and components), which now constitute almost half of the state’s Mexican exports, have expanded to historic highs via two massive surges (in the third quarter of 1993 and in mid-1997). This has largely been because of production decisions made by Nissan, but it involves many other Tennessee auto-related firms as well, for the manufacture of automobiles by all the major automotive producers is increasingly being distributed among countries. The apparel industry is involved in similar processes, which, for this state, has led to rapidly accelerating exports since mid-1995. Apparel goods are actually now the fastest growing major export to Mexico from Tennessee.

The combination of a growing Mexican economy, NAFTA-sanctioned liberalization, and the globalization of production, especially in Tennessee’s key automotive and textile and apparel industries, suggests we are seeing but the beginning of a long-term symbiosis of the Tennessee and Mexican economies, signaled by ever increasing trade between the two. In the decades down the road, this story will dwarf the recent events in Asia.

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**Mexican**

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of the movement in the index is due to but a few currencies. Only seven of the 23 currencies that compose the index moved more than four percent over the past quarter; the problem is that all but one moved in the same direction — down. Korea, where the won rose 7.5 percent against the dollar, was the exception. The bad news in Southeast Asia continued; both Singapore and Thailand fell modestly against the dollar, while Indonesia’s rupiah continued its free fall (off another 30 percent during the second quarter). But Tennessee’s real problem lay with its major trading partners. The currencies of Canada, Mexico, and Japan, the state’s top three markets, all declined against the dollar this past quarter. The near ten percent fall of the yen was particularly severe, but, for the year, the Mexican peso has been just as weak. The Canadian dollar fell 3.5 percent over the quarter. The only good news? European currencies stood pat. Even here, however, we might have hoped for better, as their modest strengthening over this past spring came to a premature end in May and June.

The strength of the American economy, combined with weakness in Japan and grave uncertainties throughout Asia, suggests the dollar will not be heading south anytime soon. Until it does, state exporters are learning to adjust to the worst foreign exchange environment many of them have ever had to face. To date, this adversity has not stopped the state from continuing to post solid export growth, but the coming months will put this performance to the test.

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**2nd Quarter 1998**

**Tennessee Trade-Weighted Dollar Index**

The dollar just won’t quit. After a brief pause this past spring, it has resumed its relentless rise. The June Tennessee Trade-Weighted Dollar Index stands at 135.02, the strongest dollar of the 1990s. The index is up four percent for the quarter, and a little under seven percent for the year.

What’s new in the second quarter is that almost all
**Tennessee International Trade Report**

Is Tennessee resistant to the Asian flu? Asia’s economic woes are clearly damaging U.S. exports. This past quarter, overall U.S. exports grew an anemic 3.3 percent from last year, and April’s figures were actually lower than a year ago. This was the first monthly loss in exports since early 1993. Yet, Tennessee exports have kept right on humming. First quarter exports were $2.582 billion, 7.4 percent higher than a year ago. And April’s figure was just as positive: a gain of 7.9 percent.

The only major sectors that have yet taken sizable hits are the state’s chemical industry, where exports have fallen by a fifth from a year ago, and industrial machinery, where foreign sales were off by a little under six percent. This is not too surprising, as the chemical industry has the largest exposure in Asian markets of any of Tennessee’s big industries. But most export sectors continued to post solid gains this past quarter. A number of large export sectors, including the state’s apparel, rubber, electronics, and industrial instruments industries, expanded their foreign sales by better than 25 percent. And agricultural crop sales were up by a third.

Why has Tennessee, thus far, fared so well? As is the case with the rest of the country, the state’s exports to Asia were down significantly. Sales to India and the rest of southern Asia were down a fifth, exports to the Chinese economic region were off 3.5 percent, and sales to South Korea dropped by better than a third. Exports to Indonesia and Thailand both fell by around 40 percent, but strong figures in the rest of Southeast Asia limited overall losses to four percent in that region.

Japan’s purchases of Tennessee goods modestly increased last quarter (4.9 percent), mostly because of its links to the state’s auto industry, but this was nowhere near enough to cover the losses elsewhere on the continent. The state’s sales to Asia dropped more than $23 million, so, unfortunately, the answer is not that Tennessee exporters are immune to Asia’s problems.

The answer to why the state has continued to do well is closer to home. We need look no further than Mexico. The growth of this state’s sales to Mexico is nothing short of astonishing. In 1997 Tennessee exports to Mexico gained 44 percent. But that remarkable figure pales next to a first quarter 1998 gain of 66.8 percent! State firms sold an additional $114 million to Mexico last quarter, accounting for two-thirds of Tennessee’s export growth. The gains have been primarily in the automotive sector, although many state industries have doubled their sales over the past year.

With a gain of better than 11 percent, South America was the state’s second most dynamic market. Here a poor performance in Brazil was more than overcome by very strong sales in the Andean states. Canada purchased 5.48% more of the state’s products, and sales to the European Union increased to $582.5 million, a 6.2 percent gain. Excepting huge gains in Turkey and Russia, the rest of the state’s markets were flat or down for the quarter.

So is the state escaping Asia’s troubles? Thus far Tennessee has not experienced a major downturn in its export performance, and this is good news. But it’s still early. And the Asian crisis is costing Tennessee firms tens of millions of dollars in foregone sales in what had previously been one of the state’s most dynamic markets. Perhaps we can say that to date the state has only caught the sniffles — not a big problem, but worth keeping an eye on.
1st Quarter 1998

The sectoral concentration of state exports continued in the second quarter.

4th Quarter 1997

The chemical industry has borne the brunt of the Asian crisis.

Tennessee’s Largest Export Sectors

<table>
<thead>
<tr>
<th>Sector</th>
<th>Exports</th>
<th>Change from Last Year</th>
<th>Change from Last Quarter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transportation Equipment</td>
<td>$562,007,449</td>
<td>17.4%</td>
<td>-1.4%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>$366,476,408</td>
<td>-19.4%</td>
<td>-14.0%</td>
</tr>
<tr>
<td>Industrial Machinery</td>
<td>$347,730,288</td>
<td>-5.9%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Electronics</td>
<td>$231,120,923</td>
<td>29.7%</td>
<td>-5.4%</td>
</tr>
<tr>
<td>Medical and Industrial Instruments</td>
<td>$153,635,875</td>
<td>27.5%</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Paper and Allied Products</td>
<td>$115,480,431</td>
<td>25.7%</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

Greatest Growth and Decline in Exports by Industry

(among sectors exporting more than $1m per quarter)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Value of exports</th>
<th>Growth %</th>
<th>Decline %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metal Mining</td>
<td>$6,992,350</td>
<td>152.0%</td>
<td></td>
</tr>
<tr>
<td>Scrap and Waste</td>
<td>$6,904,851</td>
<td>73.3%</td>
<td></td>
</tr>
<tr>
<td>Agricultural Crops</td>
<td>$98,430,727</td>
<td>33.0%</td>
<td></td>
</tr>
<tr>
<td>Electronics</td>
<td>$231,120,923</td>
<td>30.0%</td>
<td></td>
</tr>
<tr>
<td>Apparel</td>
<td>$66,798,833</td>
<td>28.6%</td>
<td></td>
</tr>
<tr>
<td>Fishing, Hunting, and Trapping</td>
<td>$728,798</td>
<td>-44.3%</td>
<td></td>
</tr>
<tr>
<td>Leather Products</td>
<td>$6,880,376</td>
<td>-33.5%</td>
<td></td>
</tr>
<tr>
<td>Lumber Industry</td>
<td>$19,231,350</td>
<td>-29.1%</td>
<td></td>
</tr>
<tr>
<td>Petroleum and Coal Refining</td>
<td>$1,782,481</td>
<td>-26.4%</td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td>$336,476,408</td>
<td>-19.4%</td>
<td></td>
</tr>
</tbody>
</table>

Tennessee’s Leading Trade Partners

State firms sold an additional $114 million to Mexico last quarter, accounting for two-thirds of Tennessee’s export growth.
Exports in $ Million

<table>
<thead>
<tr>
<th>Month</th>
<th>Value of exports</th>
<th>Gain %</th>
<th>Decline %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tennessee</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Tennessee monthly exports continue at its slower 1998 pace.)

**Fastest-Changing Export Destinations**

(among countries averaging more than $2m per quarter)

<table>
<thead>
<tr>
<th>Country</th>
<th>Value of exports</th>
<th>Gain %</th>
<th>Decline %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>$16,336,320</td>
<td>510.0%</td>
<td></td>
</tr>
<tr>
<td>Greece</td>
<td>$5,209,961</td>
<td>145.2%</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>$24,377,235</td>
<td>143.9%</td>
<td></td>
</tr>
<tr>
<td>Norway</td>
<td>$5,118,079</td>
<td>67.7%</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>$285,587,926</td>
<td>66.8%</td>
<td></td>
</tr>
<tr>
<td>Ghana</td>
<td>$3,024,715</td>
<td>-48.1%</td>
<td></td>
</tr>
<tr>
<td>Kuwait</td>
<td>$4,243,834</td>
<td>-46.4%</td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>$7,833,675</td>
<td>-43.3%</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>$14,576,206</td>
<td>-39.3%</td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>$4,675,674</td>
<td>-37.7%</td>
<td></td>
</tr>
</tbody>
</table>
Address service requested