

Indiana & The European Union

Why the EU matters for Hoosiers



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Why Does the EU Matter?

With its beginnings as the European Coal and Steel Community in 1951, economics has played an important role in the European Union (EU). In 1957, the six original countries formed a customs union, creating a common customs and tariff regime for all of the members that still operates today. Since then, as more European countries have joined, the EU has also become more integrated, as the member economies become more intertwined. The current 27 countries have a combined population of about 500 million and GDP of \$18.5 trillion in 2008, making the EU the largest economic area in the world.

Although the 27 member states still retain sovereignty over many important areas such as defense and social services, the EU now influences almost every facet of the member states' economies and citizens' daily lives. After all, member state parliaments are spending an increasingly large amount of their time simply transforming EU directives into national law. The environment, agriculture, trade, energy, and anti-trust are just a few areas where the EU often takes the lead on regulation, and these powers often directly affect the United States and Indiana. It was the EU, not the member states, that fined Intel \$1.45 billion in May 2009 for allegedly breaking EU anti-trust regulations, and the EU blocked the proposed merger of two American firms, GE and Honeywell, in 2001 even though this merger had been approved by the U.S. Department of Justice.

The 27 European Union Member States



As a result, while the member states will continue to retain important powers, the EU will play a larger role in determining world economics and thus directly affect Indiana. The European Union is not a state, yet it often acts like one. The EU's influence has increased dramatically in the past 25 years, and as member states debate granting the EU further powers, it becomes increasingly important to consider the EU. Not only does the EU have the power to regulate American firms and influence corporate decisions, but the EU is also responsible for important economic policies. The EU plays a major role in formulating and managing components of international trade policy, subsidies, and agricultural payments for the member states. These policies in turn directly affect Hoosier firms' ability to export to Europe and operate within the EU's boundaries, which will increasingly become important in a more interdependent world economy.

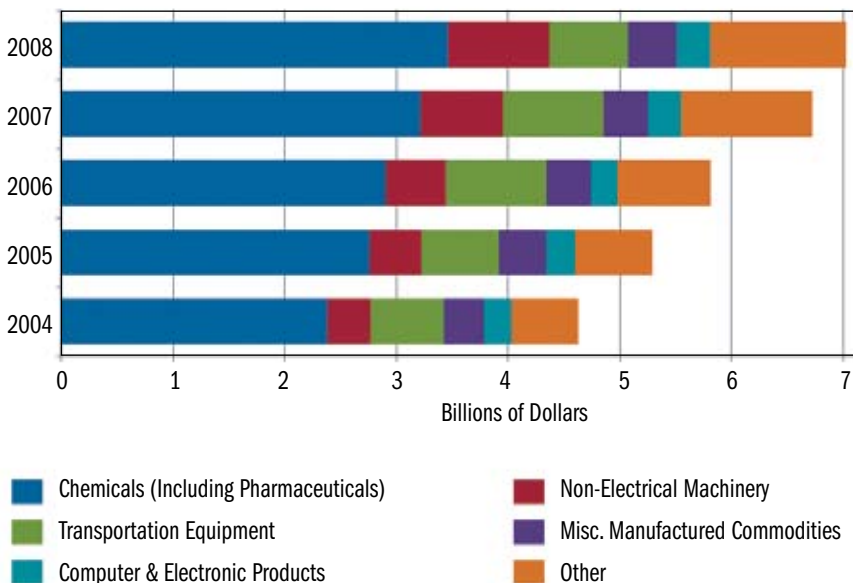
Exports

Indiana's exports to the European Union (EU) are a major component of the Hoosier economy—it is the state's second-largest trading partner. Although no official tally exists, the state and federal governments estimate that almost 72,200 Indiana jobs are generated by exports to EU members, representing about 2.5% of the state's total employed in 2008.

International trade is very important to Indiana's economy. Exports represent 10.5% of its Gross State Product (GSP), ranking Indiana 8th in the U.S. The EU accounts for 27% of Indiana's exports; among the five Great Lake states, this is the highest percentage and third largest dollar total. In 2008, Indiana exported over \$7 billion in goods to the EU's 27 member states, representing 2.8% of Indiana's GSP.

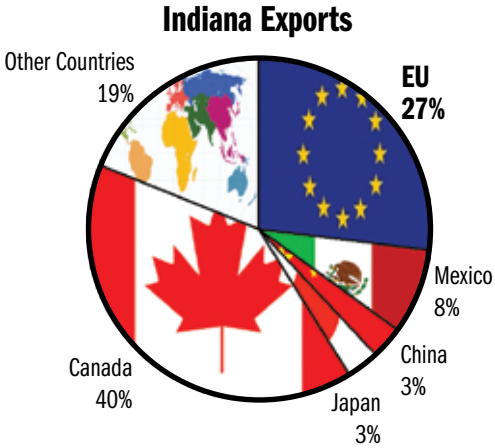
Trade with the EU has more than doubled in the last six years, which is a faster increase than with either Canada or Japan, and four times Indiana's rate of GSP growth. The rapid increase in Hoosier exports to the EU demonstrates that Indiana manufacturers continue to look for opportunities

Indiana Exports to the EU

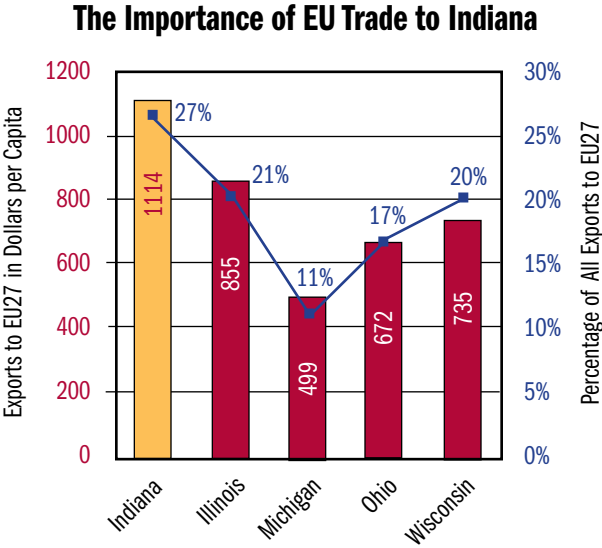


Source: World Institute for Strategic Economic Research

overseas. These trends indicate that trade with the EU will likely comprise a growing portion of Indiana’s economy in the coming years as Indiana becomes increasingly integrated in the global economy.



Source: World Institute for Strategic Economic Research

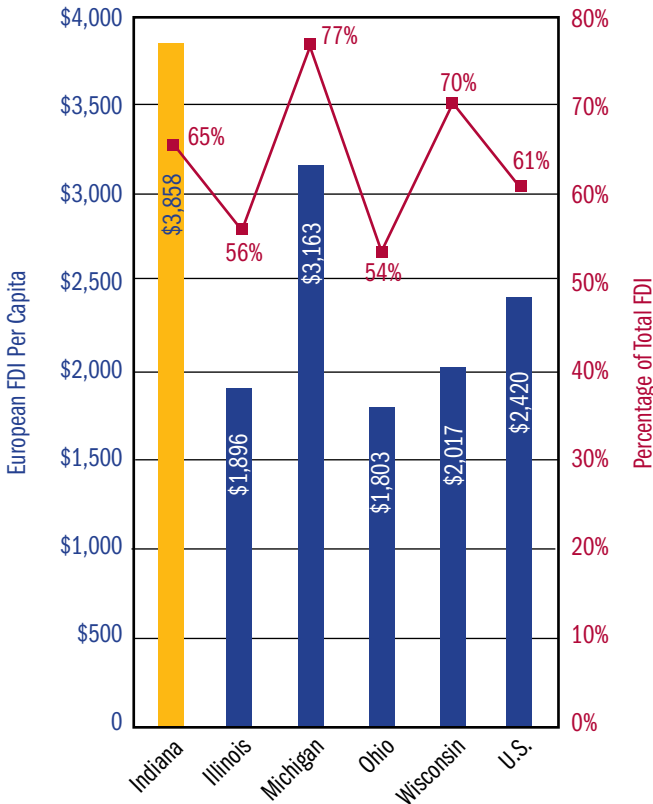


Source: World Institute for Strategic Economic Research

Foreign Direct Investment

Companies from the European Union's (EU's) 27 member states play an important role in Indiana's economy. Foreign Direct Investment (FDI) - foreign corporations establishing local branches or investing in local companies - is key to Indiana's economy. The EU is by far Indiana's largest international investor. EU firms invested more than \$24 billion in Indiana in 2006, employing 88,500 Hoosiers, which represents 3% of Indiana's workforce. As the graph below shows, Indiana depends more on the EU for investment than neighboring states do.

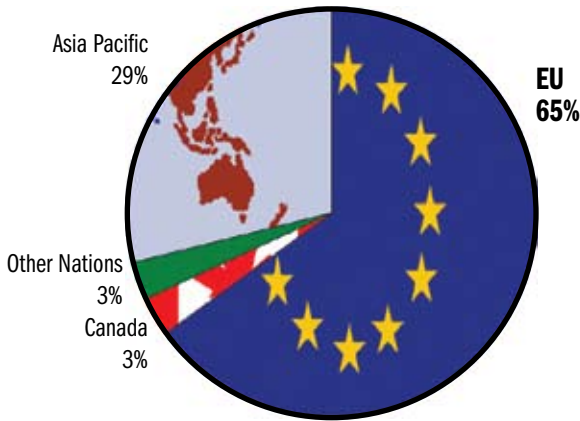
European FDI to the Midwest States (2008)*



* The U.S. Bureau of Economic Analysis provides analysis of Europe, not the EU. With Switzerland excluded from the European figures, the statistical differences between Europe and the EU are thus miniscule.

Source: U.S. Department of Commerce's Bureau of Economic Analysis

Indiana Foreign Direct Investment by Region (2008)



Source: U.S. Department of Commerce's Bureau of Economic Analysis

Indiana ranked 6th in the nation in 2005 in terms of total FDI as a percentage of Gross State Product (GSP) and 2nd out of 10 Midwest states in percentage of workers employed by foreign firms. EU firms are the biggest international investors in Indiana, accounting for 65% of all foreign direct investment (the national average is 62%). EU firms also make up 46% of all foreign companies investing in Indiana.

European FDI is particularly important for Indiana's manufacturing sector, as EU manufacturers employ 48,000 people across Indiana, representing 8.4% of all Indiana manufacturing employees – the highest in region. Four of the top seven foreign investors in Indiana are based in EU member states, including the \$3 billion BP refinery in Whiting.

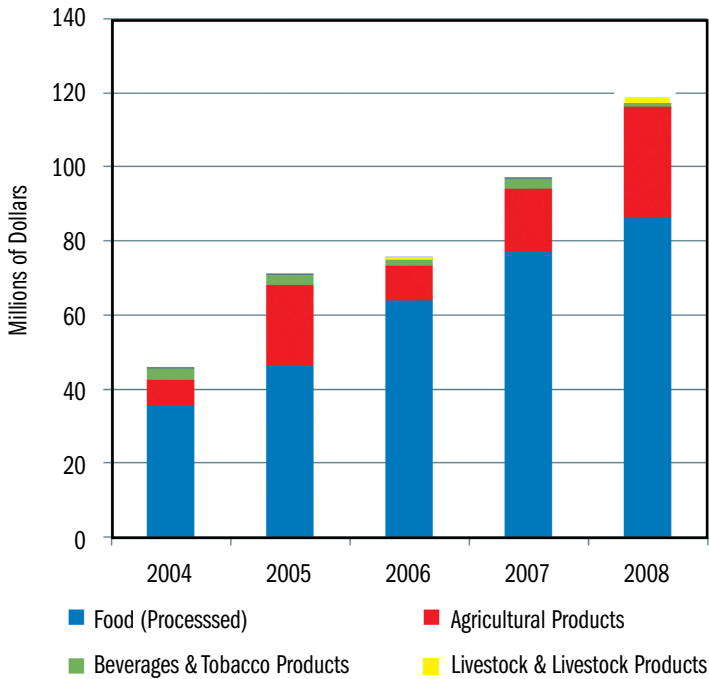
While FDI has fallen across the nation since 2002, Europe's FDI to Indiana has increased by 24%; as other states are losing business, these increases in inflows are giving Indiana a competitive edge. This trend indicates that business with the EU will likely comprise an increasing portion of Indiana's economy in the coming years.

Agriculture

The 27 members of the European Union are the second largest international market for Indiana agriculture, worth almost \$119 million in 2008. These exports accounted for 16% of Indiana's total agricultural exports in 2008, which is the largest percentage of any of the five states in the Great Lakes region.

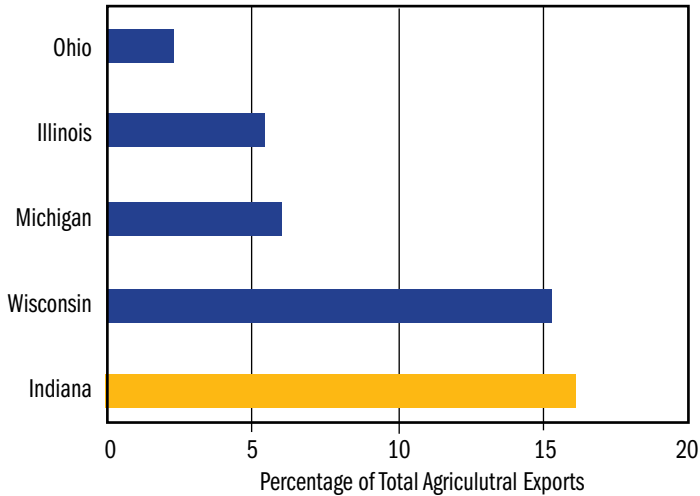
For Indiana to increase its agriculture exports to any EU country, it is important to understand the EU's role in European agricultural policy. Besides setting tariffs on agricultural imports the EU represents all 27 countries in international trade negotiations, both at the World Trade Organization (WTO) and bilaterally with the United States. For example, the U.S. took the EU, not the individual member states, to the WTO for its moratorium on genetically modified products.

Indiana's Agricultural Exports to the EU



Source: World Institute for Strategic Economic Research

Regional Agriculture Exports to the EU



Source: World Institute for Strategic Economic Research

The EU is also responsible for agriculture subsidies to farmers across the EU through the Common Agricultural Policy (CAP). With a budget of €54.8 billion (approximately \$71 billion), the CAP represents about 41% of the 2009 EU budget. Enshrined in the founding treaty of the European Economic Community (the predecessor of the EU) in 1957, the CAP's original goal was to ensure a stable food supply for its member states. The CAP went through major reforms in 1999 and 2003, as production and subsidies were decoupled. Farmers now received a fixed sum, regardless of the quantity produced. In addition to direct aid, the CAP was restructured to include stronger rural development components to improve EU farm competitiveness, environmental protection, and the diversification of rural economies.

As a result, EU farmers still receive funds from the EU, but they no longer produce the huge food surpluses. Instead, the 500 million residents of the EU now represent the world's largest food importer, offering a huge, albeit highly regulated, market for agricultural products.

Integration

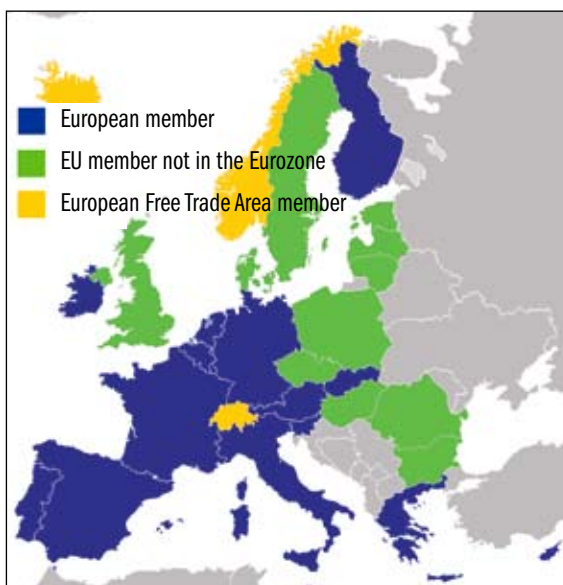
With the signing of the Treaty of Rome in 1957, six European countries agreed to form a customs union, eliminating tariffs on trade between the members and setting common customs duties on outside imports. Now the European Commission (the EU's administrative arm) controls the custom rate through the "common commercial policy." The European Commission also represents the member states in external trade matters; thus the EU speaks for all 27 countries at the World Trade Organization (WTO) and in bilateral trade talks with the United States.

The single market is the core of the modern EU. Initiated in 1986 with the Single European Act, it ensures the free movement of labor, capital, goods, and services within the European Economic Area (EEA)—the 27 member states and the four members of the European Free Trade Area (EFTA), although Switzerland has some opt-outs of all the provisions of the EEA. In principle, the EEA guarantees that goods, services, capital, and labor originating in one member country can seamlessly move to another. The main component of the EEA—the single market—does much more than facilitate free trade. The European Commission has used the Single European Act to justify its efforts to increase transnational uniformity in health, safety, and environmental policy, as well as increasing its power to regulate business. The EU has used its powers to block government subsidies to firms and prevent monopolies.

European integration is good for American businesses, as it lowers transactions costs in Europe. However, it is important for Hoosier businesses to be aware of the effects of integration in order to know how to take advantage of its benefits. For instance, Indiana firms have to deal with only one set of customs regulations when exporting to multiple countries in Europe, and the transnational nature of EU regulations has simplified many procedures for firms. These firms, however, then subject themselves to a new regulator. The result is that EU integration is helping facilitate international trade and investment and thus globalization of the world economy.

The Euro

In 1999, 12 EU members exchanged their national currencies for the euro, and since then, four more countries have joined the Eurozone (the most recent was Slovakia in January 2009). In addition, five other members have pegged the exchange rate of their national currency to the euro—meaning that this currency's exchange rate is fixed against the euro. The adoption of the



euro represents the boldest attempt at integration, as member states are giving up one of the key components of their sovereignty, since they have diminished control over their monetary and fiscal policy. States using the euro or pegged to the euro can no longer adjust exchange rates or raise interest rates (which are now controlled by the European Central Bank). Euro members must also attempt to keep their government deficits below 3% of GDP, total government debt below 60% of GDP, and low inflation.

The euro makes it possible to use the same currency in transnational transactions across the single currency area, facilitating the free movement of capital. The euro reduces transaction costs for companies, since firms no longer have to convert currencies for transactions to other countries that are also euro members. Not only does this reduce the unpredictable changes in exchange rates that previously existed, but reduces costs, as firms pay to exchange currencies. In addition, the euro has helped accelerate European financial integration, and it is now easier for banks and service firms to operate across the EU, as the same price can be set across the zone. As a result, the use of the euro has skyrocketed, representing one-third of all foreign exchange transactions.



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