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American Multinationals in an Integrated Europe

When the European Community (EC) eliminates all internal economic barriers in 1992, will new external barriers keep American firms out, or will the unified market provide better opportunities for American firms than exist today? NBER Research Associate **Robert Lipsey** argues that American firms are already well positioned to succeed in the integrated and more competitive European market that will exist after 1992.

In **American Firms Face Europe: 1992** (*NBER Working Paper No. 3293*), Lipsey notes that sales by American multinationals are not likely to suffer after 1992, even if higher trade barriers keep goods produced by American workers out of Europe. The overwhelming majority of goods sold in the EC by American multinationals are produced in the EC by European workers. Only a small fraction of the products sold by American multinationals in the EC are made in the United States and then shipped to Europe for sale by the local subsidiaries of U.S. multinationals. In 1987, sales in the EC by subsidiaries of U.S. multinationals totaled \$409 billion, but imports from the United States were less than 5 percent of their sales.

Lipsey also observes that "American firms already established in Europe are ahead of European firms in treating the EC as a single market and are well placed to take advantage of the elimination of barriers in 1992." American firms often have production and sales networks in several countries, while their European competitors tend to be more concentrated within their own home countries.

Furthermore, one of the main effects of an inte-

grated European market will be an increase in economies of scale. Today, with internal barriers to trade, domestic companies with relatively low output can produce profitably for local markets. After 1992, when internal EC barriers will be eliminated, larger firms that can benefit from economies of scale will produce for a European-wide market and will take customers away from the less efficient smaller firms. Lipsey notes that economies of scale are especially important in just those industries in which American firms are strong, such as aircraft, chemicals, motor vehicles, and office machinery.

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Despite the favorable position of American firms in the EC, there seems not to have been a large shift toward the EC in employment, financial investment, or plant and equipment expenditures by American manufacturing operations. Any moves so far have been concentrated in nonmanufacturing, including distribution and services; to some extent such moves have been made by smaller firms, firms not yet producing extensively in the EC, and firms hoping to participate in public procurement.

The Effects of Airline Mergers

The deregulation of the airline industry in the late 1970s contributed to a sharp rise in the number of mergers among major air carriers. In a new study of passenger carriers between 1970 and 1984, NBER Research Associate **Frank Lichtenberg** and **Moshe Kim** conclude that the mergers during this period led to increased load factors and lower wages for airline employees. Savings were passed on to consumers in the form of lower fares.

In **The Effects of Mergers on Prices, Costs, and Capacity Utilization in the U.S. Air Transportation Industry, 1970-84** (NBER Working Paper No. 3197), Lichtenberg and Kim examine data on labor, fuel, and other inputs used by 25 airlines from 1970 to 1984 and 10 start-up airlines between 1982 and 1984, as well as data on the carriers' passenger and freight mileage. They also consider the number of points served by each airline, its load factor, and the average length of its flights. They compare the performance of the carriers involved in the five major airline mergers occurring during the period—Northeast/Delta, North Central/Southern, National/Pan American, Air West/Republic, and Texas International/Continental—with the performance of carriers that did not merge, in order to isolate the effects of the mergers.

Prior to merging, they find, the airlines involved were 6.1 percent less efficient, in terms of costs per seat-mile and ton-mile, than other carriers. After merging, however, their output costs quickly dropped below the average cost of carriers that did not merge. During the five-year period centered on their mergers, Lichtenberg and Kim find, the costs of airlines that merged grew 1.1 percent per year more slowly than the costs of airlines that did not merge.

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One major reason for these cost reductions, the two researchers contend, is better use of capacity. The carriers that chose to merge filled a smaller proportion of their seats than other airlines prior to merging, but reached the industry average after their mergers. Lichtenberg and Kim attribute to the mergers a 4.1 percent increase in the load factors of merged airlines.

Mergers also improved carrier profitability by reducing labor costs. The increase in the average

price of labor paid by airlines involved in mergers was 4.6 percent less than the increase paid by other carriers during the same period. Merged airlines did not achieve significant savings on fuel, ground property, and materials, but they do appear to have obtained lower prices for aircraft as a result of their mergers.

Customers benefited from these economies, Lichtenberg and Kim find. They calculate that merged airlines passed 86 percent of their cost reductions on to customers. Hence, the mergers did improve air travelers' welfare. But the authors caution that their analysis applies only to mergers that were completed between 1972 and 1981. It cannot be extrapolated to reach conclusions about the large number of U.S. airline mergers since 1984, or about the potential effects of proposed mergers that were rejected by government authorities. ML

U.S. Manufacturers Pare Labor Force More Than Japanese When Production Falls

When U.S. manufacturers scale back production, they cut employment much more than Japanese manufacturers do, according to a study by NBER Research Associate **Katharine Abraham** and **Susan Houseman**. In **Job Security and Work Force Adjustment: How Different Are U.S. and Japanese Practices?** (NBER Working Paper No. 3155), they estimate that a 10 percent cut in production would cause U.S. manufacturers to reduce the size of their labor force by 3.1 percent within a month and 7.6 percent within a year. The same cut in production in Japan would cause manufacturers to reduce the size of their labor force by only 0.2 percent within a month and 2.1 percent within a year.

Both here and in Japan, production workers are pared proportionately more than nonproduction workers are. But even for nonproduction workers, within a year after a 10 percent drop in output, employment would fall by 3.7 percent in the United States, versus 0.6 percent in Japan. The decline in employment among U.S. workers is so large relative to the Japanese situation, Abraham and Houseman report, that Japanese production workers have about the same amount of job security as nonproduction workers in the United States.

Moreover, when Japanese manufacturers want to save jobs, they cut the hours worked per employee by about the same amount as American manufacturers in the same situation do, Abraham and Houseman find. One month after a 10 percent drop in output,

hours per production employee fall by 2.2 percent in the United States versus 1.9 percent in Japan. One year after the drop in output, hours per employee are only 1.2 percent lower in the United States and 1 percent lower in Japan.

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Abraham and Houseman note that the lifetime employment system in Japan applies mainly to regular employees in large companies. Only about 80 percent of Japanese female manufacturing workers are regular employees, versus 97 percent of males. Reflecting this fact, female employment falls substantially more than male employment when output in the Japanese manufacturing sector drops. The same comparison holds for women in the United States. In the year following a 10 percent fall in output, female manufacturing employment falls by 7.9 percent in the United States versus 3.8 percent in Japan. Abraham and Houseman conclude: “Japanese women enjoy greater employment stability than either American men or American women as a group.”

Abraham and Houseman's results are based on monthly data for the two countries' manufacturing sectors on movements in employment, hours, and production from 1970-85. DRH

Tax Reform Affected Charitable Giving as Predicted

The tax reforms of the 1980s sharply reduced the economic incentives for charitable giving, especially for the wealthiest taxpayers. As a result, while total contributions have continued to rise, average giving by the high-income groups has declined, according to a new study by NBER Research Associate **Charles Clotfelter**.

The 1981 tax reform act cut the top marginal rate on income from 70 to 50 percent, implicitly increasing the cost of giving from 30 to 50 cents per dollar.

However, the same act phased in a charitable deduction for nonitemizers, thereby reducing their cost of giving.

The 1986 tax act further cut the top marginal rate to 33 percent for 1988 and set the marginal rate for the highest income bracket at 28 percent. Simultaneously, the nonitemizer deduction for charity was eliminated. Deductions for personal interest and miscellaneous expenses were curtailed, the sales tax deduction was eliminated, and the standard deduction was increased. These changes made charitable giving among itemizers even more costly and removed a number of itemizers from the tax rolls. The 1986 tax reform also increased the tax rate on capital gains and added to the base of the alternative minimum tax any appreciation on donated capital assets. These two tax changes had offsetting effects on the desirability of donating appreciated property to charity. Overall, the changes in the 1986 tax reform increased the price of giving to charity for most taxpayers.

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In **The Impact of Tax Reform on Charitable Giving: A 1989 Perspective** (*NBER Working Paper No. 3273*), Clotfelter calculates that average charitable contributions by itemizers declined by about 11 percent between 1980 and 1984, primarily because of the decrease in marginal tax rates. Between 1985 and 1987, average giving declined by about 23 percent, but only a portion of this decrease was caused by the increase in the implicit price of giving that was legislated in the 1986 tax reform.

Charities favored by middle-income taxpayers were relatively untouched by the tax changes. For instance, Clotfelter reports, contributions to the United Way increased by 6.6 percent from 1986 to 1987, and by 6.9 percent the following year. Similarly, a group of 27 Protestant denominations, representing 30 percent of U.S. church membership, received a 3 percent increase in gifts between 1986 and 1987.

By contrast, donations of art to 119 art museums surged from \$76 million in 1985 to \$143 million in 1986, as taxpayers timed their contributions to take advantage of the favorable tax treatment of appreciated property. Gifts of art fell to \$95 million in 1987 and slumped further to \$67 million in 1988. During this period, art prices were booming, and the average value of donated artworks rose from \$2689 in 1985 to \$3945 in 1988.

Recent NBER Books

Tax Policy, Volume 4

Tax Policy and the Economy, Volume 4, edited by Lawrence H. Summers, is now available. The cloth volume is priced at \$26.95; the paperback is \$13.95.

This volume presents the papers and discussions of the NBER's fourth annual tax policy conference, held in Washington last November. In the first paper, Summers and Daniel R. Feenberg ask who benefits from reductions in the capital gains tax. Next, Eytan Sheshinski contrasts the tax treatment of capital income in several industrialized countries. Mark L. Gertler and R. Glenn Hubbard investigate the effect

of taxation on corporate capital structure. Alan J. Auerbach and Laurence J. Kotlikoff consider the influence of demographics on saving. Finally, Lawrence H. Goulder studies the possibility of withholding taxes on foreigners' U.S. interest income.

This volume should appeal to anyone with a basic understanding of economics who is interested in tax issues.

Summers is a research associate in the NBER's Program in Taxation and the Nathaniel Ropes Professor of Political Economy at Harvard University.

Tax Policy and the Economy may be ordered directly from the MIT Press, 55 Hayward Street, Cambridge, MA 02142; their telephone number is (617) 253-2884.



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