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EMI REVEALS CLUES TO SINGLE MONETARY POLICY

The European Monetary Institute (EMI), the precursor to the European Central Bank (ECB), has released a report on the strategic aspects of the single monetary policy in Stage III of EMU, which also sets out the monetary instruments that will be at the ECB's disposal when it becomes operational on January 1, 1999.

With the ECB's primary objective of price stability in mind, the EMI considered five possible monetary policy strategies: exchange rate targeting, interest rate pegging, nominal income targeting, monetary targeting and direct inflation targeting. Taking a number of guiding principles into account—effectiveness, accountability, transparency, medium-term orientation, continuity and consistency with ECB independence—and considering the environment likely to prevail in the euro area, EMI has narrowed the potential strategies down to two: **monetary targeting and direct inflation targeting.**

At this stage, the EMI believes it is neither possible nor necessary to spell out which strategy will take precedence; that will be for the Governing Council of the ECB to decide. Further, several variants incorporating elements of both strategies exist. Regardless of choice, however, the report identifies some indispensable elements to any strategy: a quantified definition of price stability and of the specific targets against which to assess the ECB's performance in meeting this objective; a communication policy for the ECB to explain its strategy to the general public; information on monetary aggregates for the euro area; and forecast tools for inflation and other economic variables in the euro area.

To implement its monetary policy strategy, the European System of Central Banks (ESCB) will primarily use **open market operations,** similar to the Bundesbank's securities repurchase (repo) transactions. It will also offer **two standing "facilities"** (funds)—a marginal overnight lending facility (like the Bundesbank's Lombard rate), which will act as a ceiling to money market rates, and a deposit facility, which will serve as a floor. The ECB will also be able to intervene in foreign exchange markets in support of the euro, using the pool of foreign assets transferred from the national central banks to the ECB.

Preparations for "an infrastructure" necessary for minimum reserve requirements are underway, but it has not yet been decided whether the ECB will impose them.

VAT IN THE CARDS FOR FOREIGN TELECOM FIRMS

Responding to the growing use of "callback" services, which enable EU consumers and businesses to avoid high-cost European telecom services by routing their calls through (mostly) US phone lines, the Commission has proposed that foreign firms charge VAT (value-added tax) on telecom services offered to EU customers—creating a level playing field for European competitors.

"These proposals aim to eliminate the unfair advantage enjoyed by third-country service providers," said EU Taxation Commissioner Mario Monti.

At present, non-EU-based telecom services are not subject to VAT, primarily because such "callback" services did not exist when the EU's applicable VAT legislation (the Sixth VAT Directive) went into effect in 1977. European operators have to charge VAT on calls, which ranges from 15% in Luxembourg and Germany to 25% in Sweden and Denmark.

Slated for effect on January 1, 1999, the proposal would force third-country callback operators to register in an EU country and to collect and pay VAT themselves on services they offer within the EU. In the meantime, the Commission has also proposed interim rules that would allow member state governments to collect VAT from EU companies that use "callback" services through December 1998. In both cases, the EU Council of Ministers must achieve unanimity to activate the proposed changes.

With regard to Internet and other online services in the EU, as long as the European user connects through a local telephone call —which is most often the case—the legislation will have no effect.

US Federal Communications Commission (FCC) Chairman Reed Hunt has taken a skeptical line on the EU initiative, saying that people will find a way around fundamentally unfair and economically irrational pricing systems. "The right reaction is to rationalize the trading system, not to try to tax the pressure valves," he said.

TURNING UP THE HEAT ON HELMS-BURTON

Despite the recent US waiver of the Helms-Burton Act's Title III (see EURECOM, January 1997), the EU has asked WTO Director General Renato Ruggiero to appoint a three-country dispute panel to rule on the EU's formal complaint against the controversial US anti-Cuban legislation (see EURECOM, October 1996).

Since November 20, when the EU received backing from the 130-member WTO Dispute Settlement Body to form a dispute panel, the process had been blocked by US disagreement on the panel's composition. To break this deadlock, the EU went to Director General Ruggiero on February 3—a last resort under WTO rules—who is now obliged to name a panel by February 13 (which the US cannot block). Under normal practice, the panelists would not come from the EU, the US or any other observer countries (e.g. Canada and Mexico) to the dispute. Once chosen, a panel has six months to reach a judgement.

Already, the US has mentioned GATT Article 21 as a defense, which allows member countries to ignore WTO rulings if their national security is threatened. If the US successfully uses this approach against the EU complaint, it is feared that other countries will follow the example, pleading "national security" to fend off unfavorable rulings, even when such concerns are not germane.

Commented Ruggiero: "The objective of the (WTO) dispute settlement system is to facilitate the solution of disputes, not to impose rulings on governments."

Undaunted, however, EU Trade Commissioner Sir Leon Brittan reiterated that the US waiver does not go far enough; the EU wants the entirety of Helms-Burton off the books, not just Title III.

EU LAUNCHES REVIEW OF "VERTICAL RESTRAINTS"

To generate discussion on producer-distributor agreements, i.e. "vertical restraints", in the EU, the Commission has released a Green Paper on vertical restraints in EU competition policy.

Arrangements between producers and distributors can be used in favor of competition, helping producers to enter new markets, or in anti-competitive ways, blocking market integration. Hence, the EU has applied the relevant Treaty article 85(1)—which prohibits cartels—to these agreements relatively strictly.

While this policy has operated effectively for more than 30 years, it is high time for a review: the single market is now largely in place; EU "block exemptions" (e.g. for franchising agreements) to rules governing vertical restraints will expire at the end of 1999; there have been major changes in methods of distribution that may have implications for policy; and current economic thinking recognizes the importance of market structure vis-a-vis vertical restraints.

In addition, the Commission has received complaints that the current policy is too rigid, placing too much emphasis on the analysis of clauses rather than on the economic impact of these agreements.

The Green Paper asks for comments from interested parties on the following four options: maintaining the current system; making block exemptions more flexible; limiting block exemptions to companies whose market shares are less than, say, 40%; and allowing companies with less than 20% market share to claim a "presumption of compatibility with Article 85(1)."

On a related front, the Commission has also floated for comment a revision of its 1986 Notice on agreements of minor importance *(de minimis)*, which are exempt from the provisions of Article 85(1). It proposes to eliminate the present turnover criterion (under 300 million ecu; 1 ecu=$1.17) and to adopt new market share thresholds of 5% for "horizontal" agreements (in which companies operate at the same level of production/marketing), and 10% for "vertical" agreements (in which companies operate at different economic levels).

EU, JAPAN RESOLVE TRADE DISPUTES

Two long-simmering trade disputes between the EU and Japan—one on Japan's insufficient music copyright protection (see EURECOM, March 1996) and the other on Japan's discriminatory liquor taxes (see EURECOM, September 1996)—have been settled to the EU's satisfaction in recent weeks.

In both cases, the WTO had already ruled in favor of the EU's position, but now Japan has fully implemented the changes required to comply with the WTO rulings.

After a year of tough negotiations with the European Commission, the Japanese Parliament (Diet) has adopted an amendment to its copyright legislation, bringing it into conformity with WTO rules and affording some of Europe's biggest musical names better copyright protection in Japan for the hits they produced in the 1950s and '60s.

Previous to the amendment, Japan extended intellectual property protection only back to 1971 to performers and producers of sound recordings, which meant lost royalties worth up to 100 million ecu a year for many of Europe's most successful music exports, like the Beatles, the Rolling Stones and Herbert von Karajan. Japan now offers the full 50-year protection required under world trade rules.

EU Trade Commissioner Sir Leon Brittan expressed his appreciation for the Japanese action: "This is a good day for the Golden Oldies. It not only benefits the European recording industry...but also demonstrates the effectiveness of the multilateral trading system at helping resolve disputes, open markets and prevent piracy. It illustrates the maturity of Europe's relations with Japan, and is a good result for the EU's Market Access Strategy (see EURECOM, December 1996)."

The EU and Japan have also reached an agreement under which tax on liquor imports into Japan will be reduced and brought closer to tax levels on local spirits. As a result, both European and US producers of "brown" (e.g. whisky, brandy) and "white" spirits (e.g. gin, vodka, rum) will be more competitive in the Japanese market, which currently imports a relatively small percentage of its total spirits consumption (8%) when compared with other industrialized countries like the US (35%), France (30%) and the UK (25%).

For "brown" spirit imports, currently taxed 600% more than local products, the gap will be narrowed to just 3% through huge tax decreases on the foreign stuff and smaller tax increases in the local Shochu. For white spirit imports, taxed 250% more than local swill at present, tax discrimination will completely disappear, with both being taxed equally in the future.

These changes will come in two stages—on October 1, 1997, and then a year later. The only exception to this timing is for a domestically produced Shochu B, which has until October 1, 2001 to phase in the changes. To compensate for this delay, Japan has agreed to accelerate tariff reductions on European whiskey and Brandy.

Other trading partners, notably the US, are continuing to press for a shorter transition period for Japan's new tax regime. Should the WTO arbitrator dealing with this matter reduce this period, the EU expects to receive comparable treatment.

QUOTES

"Over-regulation doesn't work, and as a result nor do millions of Europeans." UK Prime Minister ***John Major.***

"Good industrial relations strengthen competitiveness, they do not weaken it. Not only are they compatible, they are complementary." Commission President ***Jacques Santer.***

"We (the UK) can lead in Europe, and express our national identity better that way. I think people want to see the British spirit and character in the Community: openness, tolerance, a strong sense of fair play, inventiveness." The UK Labor Party's shadow Chancellor of the Exchequer ***Gordon Brown.***

"When member states of the European Union refuse even modest increases in exports such as Bulgarian strawberry jam or Polish cabbages, it does discredit to the European Union and makes it more difficult to achieve the enlargement which all countries say that they seek." British Foreign Secretary ***Malcolm Rifkind.***

"If financial markets became convinced that a European central bank could be forced by political pressure to conduct a deliberate policy of devaluing the euro against the dollar or the yen, there could be portfolio shifts of catastrophic proportions." Former German Bundesbank President ***Karl Otto Poehl.***

"Europe can't continue to be competitive with village currencies." German Foreign Minister ***Klaus Kinkel.***

"While no one is going to dominate the world economy as the British Empire did in the 19th century or the United States did in the 20th century, Europe is well placed to be the most important economic area on the globe in the 21st century." MIT economist ***Lester Thurow.***

CASH TRANSFER RULES (FINALLY) ADOPTED

In an important victory for EU consumers, a directive establishing rules for cross-border money transfers has been definitively adopted after a long but ultimately successful conciliation procedure between the Council and the European Parliament (see EURECOM, October 1995).

The legislation will require member states to ensure that credit institutions transferring 50,000 ecu or less between EU countries adhere to the following standards: that customers be informed beforehand about the conditions, terms and costs associated with a transfer; that funds be credited to the beneficiary's account within six working days; that unauthorized double-charging is illegal; that if double-charging occurs, the onus will be on the originator's bank to reimburse the beneficiary; and that "lost" transfers must be reimbursed in full to the originator by the originator's bank, up a ceiling of 12,500 ecu, within 14 business days.

Commented EU Financial Services Commissioner Mario Monti: "This is a crucial piece of legislation for private individuals and small businesses; rapid and reliable cross-border money transfers are the lifeblood of the single market."

Initially, the Council wanted to set the threshold for transfers at 25,000 ecu, but the European Parliament fought for and eventually secured the 50,000 ecu limit in the legislation.

Now the member states have 30 months to implement the directive. Two years after implementation, the Commission will submit a report to the Council on how the rules are working.

...IN BRIEF

...Following two consecutive years of surplus, the EU recorded a 2.9 billion ecu trade deficit in 1995 with the **North American Free Trade Area** (NAFTA)—the US, Canada and Mexico. According to Eurostat, trade with NAFTA comprised some 21% of the EU's total trade (18% with US, 2% with Canada and nearly 1% with Mexico). And manufactured products dominated the EU's NAFTA trade flows, taking 78% of imports and 90% of exports. **EU imports** were led by **office machinery and computers** (12.7 bn ecu), electrical machinery and appliances (10.2 bn) and other transport equipment (7.4 bn), mainly aircraft. Top **EU exports** to NAFTA included **road vehicles** (12.4 bn ecu), specialized machinery for particular industries (8.3 bn) and electrical machinery and appliances (6.9 bn). In 1995, almost 25% of EU imports from NAFTA went to the **UK**, followed by Germany (19%) and France (14%). **Germany** was by far the biggest EU exporter to NAFTA, sending over 29% of the total. Next came the UK (19%) and France (14%).

...Up to 1.3 million jobs could be created across the EU by 2005 through a rapid liberalization of the telecommunications sector according to an independent study carried out by the French consultants BIPE Conseil (on the European Commission's behalf). Under this scenario, through lower prices and accelerated diffusion of services, the telecom sector would become a locomotive for many other sectors, generating jobs in the rest of the economy. While "traditional" state-owned telecom operators could lose up to 286,000 jobs, this would be more than compensated by job creation in the sector as a whole, resulting in a net gain of 93,000 jobs over the period. However, slower rates of liberalization or technological diffusion would probably lead to a lower rate of job creation—and missed opportunities.

With few exceptions, January 1, 1998 is the deadline for the full liberalization of the EU's telecommunications market.

...EU average annual inflation in December remained at the **record low of 2.2%** achieved in November 1996. In December 1995, the rate was 3.0%. Six member states registered inflation rates below the EU average—all under 2%—while a total 12 EU countries had annual inflation rates of less than 3%. At the low end of the scale, Sweden and Finland experienced minuscule price increases of 0.2% and 0.8%, respectively. As usual, Greece had the EU's highest rate at 7.5%, but even this represents improvement: in December 1995, Greece had a 8.1% rate. At least in terms of price stability—arguably the most important of Maastricht treaty's EMU criteria—the EU has significantly "converged".

...The Commission has opened a full-scale investigation into the **merger of British Telecommunications** (BT), the UK telecom company, **with MCI**, the US long-distance carrier, under the EU's merger regulation. Although many of the parties' activities are complementary, there are a number of areas in which further investigation is required, including: possible impairment of major rivals' competitive positions on the UK-US route; unfair diversion of US-European traffic through the UK; and limitations on availability of transatlantic cable capacity to new market entrants. In addition, the investigation will examine the merger's potential impact on the teleconferencing market. The Commission now has a maximum of 4 months to complete its inquiry and take a decision on the case.

BT and MCI already operate a joint venture known as Concert, which supplies value-added telecom services to multinational companies.

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