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INTER-REGIONAL TRADE ACCORDS WITH MERCOSUR AND CHILE PROPOSED

Despite caveats from certain member states, the European Commission has asked the Council of Ministers for a negotiating mandate for inter-regional association agreements (IAAs) – including eventual free trade areas (FTAs) – between the EU and Mercosur (the Southern Cone Common Market) and Chile (a Mercosur associate member), respectively.

Mercosur was established in 1991 and includes Argentina, Brazil, Paraguay and Uruguay. On January 1, 1995, it achieved a customs union liberalizing intra-regional trade and a common external tariff for the four countries' trade with third countries or groups of countries. And the Ouro Preto Protocol gives Mercosur international legal personality with external representation and the capacity to negotiate with third countries or groups of countries. Sound familiar?

Building on an existing cooperation accord (see EURECOM, January 1996), the IAAs would cover partnership in political and security matters, greater economic and institutional cooperation and the phased-in establishment of FTAs for goods and services, taking into account sensitive sectors (e.g. agriculture) while respecting WTO rules. In addition, all sides would open up competition in public contracts, liberalize movement of capital and payments, adopt appropriate disciplines in the areas of competition policy and intellectual property and not discriminate against investors.

According to the Commission, the potential benefits of these accords are legion. Already, the EU is Mercosur's leading trading and investment partner, and Mercosur and Chile form one of the most dynamic emerging areas of the world economy (current market turmoil notwithstanding). With over 200 million inhabitants and a GDP of 1 trillion ecu (1 ecu=$1.13), Mercosur is the fourth largest single market (and customs union) in the world after the EU, the US and Japan. Between 1990 and 1996, EU exports to the region increased by 250%, and EU direct investments have flooded into strategic sectors such as cars, petrochemicals, telecommunications and banking.

Moreover, Mercosur's development, which rests on the progressive opening of its internal market to competition, is largely inspired by the European experience and comparable in its objectives to the EU.

Regarding Chile, despite a relatively small population and market, it is playing a key role in regional and multilateral trade liberalization. It also has formal links with Mercosur and numerous preferential agreements with other Latin American countries. Most of Chile's direct investment in manufacturing industries and services comes from Europe.

There are, however, some concerns in EU circles. For example, French Agricultural Minister Louis Pensec warned that free trade pacts with Mercosur and Chile could inflict "serious damage" on EU agricultural markets. Similar concerns recently derailed a Commission proposal for a "New Transatlantic Marketplace" between the EU and the US (see EURECOM, June 1998), which aimed to remove remaining barriers to transatlantic trade.

The regional integration process begun by Mercosur has provided the signal for a far-reaching integration process in the Americas; the Commission wants to ensure European economic operators are not left out.

A GLUTENOUS DISPUTE: EU "TIT" FOR US "TAT"

In response to a US decision on June 1 to apply a safeguard clause in the form of a quantitative restriction on wheat gluten imports from the EU to the US, the Commission has proposed to suspend certain concessions on corn gluten feed imports from the US.

The proposal calls for a 5 ecu per ton duty rate on US corn gluten imports of 2.73 million tons, amounting to about 13.65 ecu a year, which is the estimated cost to the EU of the US action (starting in 2001). Under the World Trade Organization (WTO) Agreement on Safeguards, any member affected by a safeguard action may respond by suspending "substantially equivalent" concessions three years after the measure takes effect (or earlier if the safeguard is not in conformity with the WTO agreement).

When the US announced its action, the Commission expressed its "astonishment" that the US, which continually urges WTO members to liberalize their markets, should choose not only to apply one of the most trade restrictive measures, but also to do it in a discriminatory and dispropor-

tionate manner. For instance, the EU quota allocation for the period June 1, 1998 to May 31, 1999 was set at 24,513 tons per year, considerably lower than the 1997 level of EU exports to the US of 41,239 tons. Other targeted countries, like Australia, received a quota equal to its 1997 exports, while other countries (namely Canada) were totally excluded.

Further, and even more surprising, the EU and its wheat gluten industry cooperated fully in consultations requested by the US, and in the investigation by the US International Trade Commission. The EU submitted clear evidence that the US wheat gluten industry's difficulties arose from economic factors, especially the price advantage of US corn over US wheat in the production of derivatives.

In addition to the proposed EU response, the Commission is considering a complaint to the WTO's Dispute Settlement Body against the US "safeguard".

GROWING CONSENSUS ON INTERNET MANAGEMENT

The Commission has released a new Communication on Internet Governance, which deals with questions on the future management of Internet names and addresses. Not only does the Communication assess the US Administration's recent White Paper on these issues (published June 5, 1998), but it also welcomes that the US has taken on board the EU's most important concerns and criticisms regarding an earlier US "Green Paper" (see EURECOM, March 1998).

Now the EU, the US and the international community agree that all pending decisions on Internet governance should be referred to the new private sector, self-regulatory ***Internet Assigned Numbers Authority*** (IANA), which will be created in the next few months. The US White Paper calls for the creation of the new body, at least on an interim basis, by the end of September 1998. Although this timetable is extremely tight, the Commission is supporting the objective because there is an interest in Europe to open the existing generic Top Level Domains to competition as soon as possible.

Moreover, the US has endorsed the principle – and the Commission's view – that IANA should have a balanced, internationally-constituted membership and board, and that the World Intellectual Property Organization (WIPO) should continue to play a central role in the development of dispute resolution and trademark policy for the Internet. Consequently, the Commission is urging the European private sector to participate actively in the implementation phase.

For a complete text of the Communication or more information about European policy in this area, please consult the EU's Information Society Project Office server at *http://www.ispo.cec.be/eif/.*

A REGULATORY FRAMEWORK FOR ELECTRONIC MONEY

To promote the development of electronic commerce within the EU, the Commission has put forward measures comprising a regulatory framework for electronic money ("e-money").

E-money is defined as monetary value stored on a chip card (i.e. an "electronic purse" or pre-paid card) or on a computer memory (network or software money) which is acceptable as a means of payment by undertakings other than the issuer.

By ensuring that institutions issuing e-money are stable and sound, the proposals would help build business and consumer confidence throughout the single market. In addition, they would make small payments in euros easier in other member states — without having to convert national currencies — during the three-year transition period.

To maintain a level playing field between traditional credit institutions and issuers of e-money, the Commission has proposed extending the EU's First and Second Banking Directives to cover these new firms. This would allow e-money enterprises not wanting to offer the full range of banking services to still operate throughout the single market on the basis of a "single passport" (i.e. authorization from one member state) subject to home country control. At the same time, all issuers of e-money could be subject to reserve requirements imposed by the European Central Bank (ECB) as part of monetary policy measures. (Relatedly, the ECB has called for tough minimum requirements for issuers of e-money products – i.e. being subject to prudential supervision and possible reserve requirements – to prevent e-money from turning into a rival monetary unit).

A second proposal would define e-money in a technology-neutral manner, and would set out the type of business activities that e-money institutions could undertake. It would also establish rules concerning prior authorization, initial capital (minimum 500,000 ecu), minimum prudential requirements, ongoing supervision and application of related Directives (e.g. Money Laundering, Consolidated Supervision).

In both cases, the proposed measures will be submitted to the Council of Ministers and the European Parliament for adoption under the co-decision procedure.

EU INVESTIGATES HIGH-PRICED CALLS

Lately, the Commission has been exercising its watchdog role vis-a-vis EU telecom services – with the consumer in mind.

Following an inquiry into **high mobile communications prices** in all 15 EU member states, the Commission concluded that at least 14 cases warrant in-depth investigation based on preliminary indications of excessive or discriminatory prices. In five instances, the Commission will stay its own inquests in favor of action by relevant national authorities, leaving it nine cases against operators in the following member states: Belgium, Ireland, Austria, Spain, The Netherlands and Germany.

Launched in January 1998, the Commission's initial examination focused on interconnection charges between fixed and mobile operators due to growing concern about persistently high prices for mobile communications (particularly fixed-to-mobile calls, which are more complex than fixed-to-fixed or mobile-to-mobile calls). Noting that its preliminary

conclusions are "only indicative", subject to further inquiry, the Commission will take into account recent or future price changes by the operators as the investigations go forward.

On the fixed **international phone calls** front, the Commission is investigating seven dominant European telephone operators – OTE (Greece), Post & Telekom Austria, Postes et Telecommunications Luxembourg, SONERA (Finland), Telecom Eireann, Telecom Italia and Telecom Portugal – for predatory pricing through accounting rates charged to forward international calls.

Following a preliminary assessment, it appears that the international accounting rates charged within the EU by the seven operators may result in excessive margins. Although liberalization of the EU telecommunications market allows other systems to be used, a significant proportion of cross-border calls within the EU is still forwarded through the traditional accounting rates system, which is based on bilateral agreements between carriers.

QUOTES

"Enlargement begins to look as if it could divide as much as unite Europe... Short-run, domestic interests are dominating, with little sign of strategic leadership from any of the (EU) member states...Not only could enlargement be a very long way off, but the half-hearted process of getting there could be damaging...to both sides." ***Kirsty Hughes****, deputy director, Institute for Public Policy Research.*

"Anything we would discuss on giving assistance to Russia – which obviously with others we are prepared to do – can yield no result or success until the political problems are first addressed." EU Commissioner ***Hans van den Broek****.*

"Clearly there will be concern about events in Asia spreading to Russia and Latin America, and how this could effect Europe. It will not be strong enough to pull apart the glue of convergence in Europe." ***Avinash Persaud****, head of currency research, JP Morgan.*

"We have the most cowardly government in Europe on this issue. This head-in-the-sand approach to the euro is threatening our international credibility." ***Carl Bildt****, leader of Sweden's Moderate opposition party.*

THE RUSSIAN CRISIS: A FIRST ASSESSMENT

Just back from the August recess, the Commission has promptly reviewed recent economic and political developments in Russia and made a first assessment of the potential impact on the European economy.

First and foremost, the economic and financial crisis is worrying because it is likely to have negative consequences for the Russian economy and the Russian people. And as the Commission and member states have underscored, the main responsibility for ending the crisis lies with the Russians themselves.

Unless the stabilization and reform program agreed with the international financial institutions is fully and decisively implemented, Russia risks reversing its hard-won progress toward establishing a market economy. It is vital to establish a new government quickly and to put in place a credible economic program.

Under the present circumstances, the Commission will use the flexibility of its TACIS program (Technical Assistance to the Commonwealth of Independent States) to mobilize expertise for technical assistance in priority areas such as public finances (especially tax collection), financial sector restructuring and institutional reform. Further, the Commission suggests that the Russians should make use of its Partnership and Cooperation Agreement with the EU to reinforce their institutional and economic structures; calls for greater private sector contributions to resolving the crisis; and stresses the need for improved cooperation in the international response.

As for the EU economy, the initial view is that direct effects will be limited. Because Russia only accounts for around 4% of EU trade, the trade consequences will be small. Potential hits on the banking sector, should they materialize, are likely to be manageable, as exposure to Russia is relatively low compared with total external exposure (and as compared with exposure in Asia). Nevertheless, the general impact on confidence could become more pronounced if the present high degree of volatility on stock markets continues. Of course, recent dips in EU markets are from historically high levels, and there has been a mitigating decline in European interest rates through a "flight-to-quality" effect. In addition, the Russian crisis comes at a time when both the US and European economies are in good shape to withstand possible negative effects.

As EURECOM went to press, the Commission was examining ideas coming out of Russia for a possible currency board arrangement. However, any currency board system should be viewed as a policy instrument for – not a miracle solution to – present economic difficulties. Confidence of financial markets is a vital precondition for the success of any such system; in Russia, this depends on recovering political stability and a credible economic reform program.

...IN BRIEF

...Outward foreign direct investment (FDI) by EU member states – both inside and outside the Union – rose 46% to 172.3 billion ecu in 1997, outpacing inward FDI, which also increased by a healthy 38% to 99.2 becu. According to Eurostat, FDI flows are "one of the major aspects of globalization" which, along with trade, serve as "a mechanism for integrating international markets." **Germany** easily remained the EU's largest net exporter of FDI capital (29 becu), followed by **the UK** (20 becu), by far both the EU's largest outward investor (51.5 becu) and inward recipient (31.5 becu). EU FDI flows to the US more than doubled last year, growing

from 15.5 becu in 1996 to 37.5 becu in 1997 and accounting for 41% of total extra-EU outward FDI. This is mainly due to **UK investors**, who plunked down nearly half of the total EU flows to the US. In the other direction, US firms upped their FDI to the EU by 42% between 1996 and 1997 to 21.4 becu. Once again, **the UK** was the biggest beneficiary, taking almost two-thirds of total US inflow to the EU (compared with 57% in 1996). **France** was a distant second (2.3 billion), whereas **Sweden**, which experienced a six-fold increase in inward US FDI in 1997, was a surprising third (1.95 becu). Only **Belgium/Luxembourg** experienced US disinvestment (-1 becu) among EU countries last year.

...For the ninth year in a row, **Germany** (excluding former East Germany) is the most expensive country in the world in terms of manufacturing labor costs. Based on the German Economic Institute's (IDW) 1997 annual survey of labor costs in the industrialized world, Germany took the dubious honor with an average hourly wage of $27.70, followed by **Norway** ($25.20) and **Switzerland** ($24.78). In addition, the "non-wage" component (i.e. benefits such as health insurance, paid leave and social security) of Germany's hourly rate is by far the world's highest at $12.46 per hour. Amazingly, while the average hourly wage in Germany's **New Länder** is less than in former West Germany, at $19.06, it is higher than all other G-7 countries except Japan ($20.21). Among the 22 countries surveyed, EU member states **Greece** ($9.15) and **Portugal** ($6.39) had the lowest labor costs. Despite a stronger dollar in 1997, the US still came in at a very competitive $18.40 per hour.

...On September 23, 1998 in New York City, Niche Systems, together with the US Council for International Business, the Foreign Policy Association and The Royal Institute of International Affairs, is putting on the "seminal" conference on the implications of EMU for the US: ***"US Business and Economic Policy for the New Europe".*** North America's leading euro experts will come together to discuss practical business implications such as tax issues, financial systems and pricing strategies. Keynote speakers include **Barton Biggs**, chairman, Morgan Stanley Asset Management, European Commission Vice President **Sir Leon Brittan** and former US Federal Reserve Chairman **Paul Volcker**. The Commission's New York Representation will host a reception. For more information, please contact Virginia Gilbert, Foreign Policy Association, at (212) 481-8100, or consult the following website: *http://www.nsinc.com.*

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