eurecom

MONTHLY BULLETIN OF EUROPEAN UNION ECONOMIC AND FINANCIAL NEWS

VOLUME 11, NUMBER 3 MARCH 1999

FROM TRADE DISPUTE TO TRADE CONFLICT: US SANCTIONS EU OVER BANANAS

"What do bananas have to do with cashmere sweaters," asked Gerald Sampson, president of US retailer Neiman Marcus.

Good question.

Adhering to its congressional pledges rather than to WTO timetables and procedures, the US Administration introduced sanctions (i.e. "withholding liquidation") on imports of selected EU products valued at over $500 million as of March 3, 1999 in retaliation for the EU's alleged non-compliance with a WTO ruling on its controversial banana trade policy (see EURECOM, January and February 1999) – without the WTO's approval.

This "withholding liquidation" imposes contingent liability for 100% duties on affected products as of March 3, but with the actual collection of the punitive duties starting only after the release of a WTO arbitrator's report on US damage claims – a report which had been due March 2 (see EURECOM, February 1998), but was postponed by the panel (probably an additional two weeks) for more information from both sides. US importers will therefore have to post bonds with the US Customs Service to cover the 100% duties on selected EU goods, ranging from those cashmere sweaters to sweet biscuits and Pecorino cheese. While "respecting" the desire for more information, the US decided to "protect" its interests while the arbitrators complete their deliberations, ensuring that "the EU's failure to implement WTO rulings in accordance with WTO timetables is not without consequence."

EU reaction was immediate and clear. EU Commission Vice President **Sir Leon Brittan** accused the US of defying the WTO system by introducing unilateral sanctions without any WTO authorization whatsoever. In fact, the WTO arbitrators expressly stated that they were not ready for a decision on the US sanctions request, and that they were in no way authorizing such an action. Further, the US measures run contrary to GATT (Articles 1 and 2) and the WTO (Article 22.6), which forbid such actions while arbitration continues.

"What the US has done is therefore both unacceptable and unlawful," said Sir Leon. "Just at the time when we should both be working towards a settlement, the United States is fanning the flames of this dispute...They have risked a major trade confrontation for the sake of a couple of weeks."

"It is simply irrational for them to do so, quite apart from being objectionable, and it is not in their interests," added Sir Leon.

By the US' own admission, the measures will damage jobs and prosperity. And they will have a "chilling effect" on trade, because imports will not get through.

The EU has demanded immediate consultations with the US in the WTO, and it will include the latest US maneuver in its WTO case against Section 301 of US trade law, which is the basis of the US retaliation. Sir Leon ruled out the possibility of EU retaliatory sanctions, saying that its response would remain entirely within the WTO framework.

The panel report examining whether the EU's banana modifications comply with WTO rules is still scheduled for April 12, 1999.

EU UNVEILS WTO ACCESSIONS INITIATIVE

On a more positive note, the prospect of a new multilateral trade Round has prompted an EU proposal for a "WTO Accessions Initiative", which aims to bring as many new countries into the WTO as soon as possible by the end of this year, so that the political and economic benefits of broad, rules-based trade liberalization can be maximized across the globe.

At present, over 30 countries are seeking WTO membership, not just the highly publicized cases of Russia and China. Many of these candidates were centrally planned economies that are now going through painful economic restructuring as they work towards integrating into the world economy and international institutions. Many developing countries have also boldly embraced structural economic reforms, and they seek to consolidate these changes through WTO membership.

According to European Commission Vice President **Sir Leon Brittan,** who announced the Accessions Initiative last month, now is the time for a new concerted effort to include as many of these

EVS:2

countries as possible. "It is in their interests and ours that they be brought into the WTO as soon as possible. In doing so, we will be supporting their reform programs and at the same time fulfilling the WTO's universal vocation," said Sir Leon.

"The WTO can, and should, embrace all trading nations."

Achieving this will not be an easy task. It will require more intense and sustained negotiating energy from all the WTO's present members who are, at the same time, also involved in preparations for the third WTO Ministerial in Seattle in November. A special effort will be needed for the least developed countries, requiring less from them in terms of conditions for membership than in the past, and speeding up the process by having a uniform approach to their accessions.

Nevertheless, the key to the initiative's success is in the hands of each applicant country. The WTO is an organization in which members accept clear and firm obligations to open their markets in return for the access to other markets they are guaranteed. Acceding countries will therefore have to offer similar commitments to those already negotiated by GATT and WTO members in the eight Rounds and 50 years of multilateral trade rules.

The Commission is prepared to make the extra effort, because the more countries involved when the new Round opens, the better for everyone. And once the Round is under way, it will be harder to focus on accessions.

On **China's WTO application**, Sir Leon welcomed recent US efforts to advance China's membership bid, but he cautioned that WTO accession negotiations are a multilateral process, and that no bilateral agreement between China and a third country can be imposed on other WTO members as a basis for a final accession deal. For the EU, it is fundamental to the talks' success that all bilateral concessions made by China to individual countries be extended to all other WTO parties on a non-discriminatory basis.

In the context of the Accessions Initiative, Sir Leon will travel to China in late April to move the Chinese talks forward, building on the momentum from the recent Sino-US discussions. Throughout these negotiations (see EURECOM, January 1997), the goal has been the same: to assist China's integration into the world economic order while reflecting the legitimate interests of both China and its trading partners.

NO REPRIEVE FOR EU DUTY-FREE SALES

Despite some significant member state misgivings and intense lobbying from luxury goods, tobacco and spirits industries, the Commission has decided against an extension of intra-EU duty-free sales beyond the long-established cut-off date of July 1, 1999.

Responding to the Vienna European Council's request to examine the employment consequences of duty-free's abolition (and to consider the possibility of a limited extension), the Commission found that ending duty-free will not have a negative overall impact on jobs. Further, extending such sales would create legal uncertainty and delay the necessary adjustment process, penalizing operators which have already started to adapt.

National studies carried out by five member states (the UK, France, Denmark, Ireland and Sweden) confirmed the Commission's conclusion that aggregate employment levels would not be affected, but they did find that specific, local dislocations could arise. Given the EU's priority of employment, the Commission urges the member states to counteract any short-term regional difficulties by reallocating appropriate Structural Funds to the problem areas.

The Commission further noted that travel-based sales would continue without duty-free. Most travelers will continue to shop during waiting time at the airport or on the ferry, which is confirmed by the experience of US airports, where there is an ongoing expansion of tax-paid shopping malls. An attractive location with a "captive" clientele is already, in itself, advantageous.

In addition, the price differences between duty-free and regular shops are often very small (especially for goods other than tobacco). Consequently, a significant impact on total sales is not expected. Any potential reduction in sales in airports/aircraft and ferries is also likely to be counterbalanced by a corresponding increase in ordinary shops, whose representatives have complained to the Commission about the distortion arising from duty-free sales.

Last, tax revenue that is no longer lost through duty-free could be used to help create jobs by, for example, reducing the tax burden on labor.

For those US travelers going from EU territory to third countries (or back to the US), duty-free shopping opportunities will continue to exist.

The EU member states voted unanimously in 1991 to end duty-free sales by July 1, 1999 as part of the single market program and the scrapping of intra-EU border controls. To reverse this decision would also require a unanimous vote, something that is clearly not achievable at present.

A NEW FRAMEWORK FOR EU PATENT PROTECTION

To improve the framework for obtaining patent protection in the EU, the Commission has just released a policy Communication containing a series of ambitious measures.

"This coherent policy framework lays the foundation for ensuring that pan-European patent protection can be obtained more easily and cheaply than at present. This will serve to promote investment in innovation, which is so crucial to employment, growth and competitiveness in the EU," said EU Single Market Commissioner **Mario Monti**.

The measures include: a proposal for a Regulation to establish a unitary EU patent valid throughout the Union; a proposed Directive on patent protection of inventions related to computer programs; an interpretative text on freedom to provide services for patent agents; and a pilot action to support efforts by national patent offices to promote innovation.

Concerning a unitary EU patent, it would be valid, with immediate effect, on the basis of a single application. It would also coexist with patents issued by national offices and the European Patent Office (established by the 1973 Munich Convention), providing innovative businesses a choice of protective systems. The pending proposal will reflect the clearly expressed need (following a 1997 Green Paper) for a unitary Community patent, covering the EU's entire territory, which would facilitate the management of patent rights in the single market.

The proposed Directive aims to harmonize the conditions for the patentability of inventions related to computer programs, so that software companies can obtain effective patent protection for their inventions in all member states. Due to divergent approaches in different EU countries, this is currently not possible.

For more detailed information, check out the following site at: *http://europa.eu.int/comm/dg15.*

QUOTES

*"The US and the EU are the only economic superpowers and the only two regions enjoying reasonable economic growth. They created the GATT system...and the WTO. Despite their own occasional transgressions, they have nurtured and defended the system...over the past 50 years...Their failure to maintain that commitment would devastate the entire regime." **C. Fred Bergsten,** director, Institute for International Economics, from his recent article in* Foreign Affairs *(March/April 1999).*

*"If we want to resolve a certain number of crises, we can only do it together, not separately. The world economy functions with two engines: the US and Europe. They must get along." French President **Jacques Chirac** during his US visit last month.*

*"It is crucially important that Japan and Europe...move forward with domestic demand-led growth in their economies, to achieve more balanced growth among our countries, reduce the large external imbalances and support recovery in emerging-market economies." US Treasury Secretary **Robert Rubin** after the Bonn G-7 meeting.*

*"There is a schizophrenic attitude in the United States to European integration. Most Americans favor it, but some get nervous when it looks like it will work and really be successful." European Commission Ambassador to the US **Hugo Paemen.***

*"The dominant (US) reaction to the euro is one of optimistic skepticism. A common view is that it's a good idea, if they can pull it off. But can those disparate countries subsume their national interests and provide a pan-European policy?" Chase Manhattan Bank Chief Economist **John Lipsky.***

A SECOND LOOK AT MALTA'S EU BID

Following Malta's decision to reactivate its "frozen" EU membership bid in September 1998, the Commission has updated its original 1993 Opinion on Malta's membership application, finding that it is making good progress in its preparations.

Before Maltese general elections in October 1996, when the (then) newly elected government decided to freeze the EU membership application, Malta, along with Cyprus, had been at the top of the EU's enlargement list. Another general election and change of government in September 1998 brought about a reverse in policy back toward joining the EU, but it left the tiny island nation no longer in the first wave of EU applicants (see EURECOM, January 1998).

EU Foreign Affairs Commissioner Hans van den Broek said that the Commission, based on Malta's good performance, has recommended that the Council of Ministers give the go-ahead for the Commission to screen Malta's existing legislation, with a view toward starting negotiations by year's end. The Commission will now work with the Maltese government to formulate a comprehensive national plan for accession, concentrating on improving Malta's competitiveness and accelerating its implementation of the *acquis communautaire* (the body of existing EU law).

It is hoped that Malta will be able to join the candidate countries with which accession negotiations are already underway (i.e. Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia).

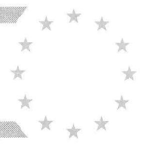
The Opinion points out that Maltese enterprises, particularly those in the public sector, will need restructuring; that the budget deficit will have to be reduced; that the January 1999 introduction of a VAT system should be augmented with additional measures to align Maltese law fully with the *acquis* in that field; and that Malta will have to adapt to the EU's Common Customs Tariff and abolish taxes on imports of certain products.

In a related development, the Commission is stepping up membership preparations for five Central and Eastern European countries – **Bulgaria, Latvia, Lithuania, Romania** and **Slovakia** – similar to those for Malta. This bilateral process will help identify areas that need the most attention, enabling these countries to be fully ready for accession talks when, at the appropriate moment, they are opened.

The Commission's Task Force for Accession Negotiations has a website: *http://europa.eu.int/comm/tfan/index_en.html.*

...IN BRIEF

...Euro-zone annual inflation remained stable at 0.8% in January (yes, your eyes are fine), compared with 1.1% a year ago. And annual inflation in the **EU15** fell from a whopping 1.0% in December 1998 to 0.9% in January 1999 (January 1998: 1.3%). Among the member



states, **Luxembourg** had by far the lowest rate at -1.4% (more accurately, its deflation rate!), followed by **Sweden** (0.0%) and Germany (0.2%). Highest were Greece (3.5%), Ireland and the Netherlands (both at 2.1%). Over the same period, annual US inflation rose to 1.7%, while it fell to 0.2% in Japan. But these indices are not strictly comparable with the EU's harmonized indices (HICPs).

...Among 11 Central and Eastern European (CEEC) countries, **Slovenia** is the most expensive country in terms of manufacturing labor costs with an average hourly wage of $6.32, just under that of the EU's low-cost country, Portugal ($6.39), but only around one-fourth of "world champion" Germany's $27.70. An extension of the German Economic Institute's (IDW) annual survey of labor costs (1997) in the industrialized world (see EURECOM, September 1998), the CEEC version of the study identifies **Bulgaria** ($0.82 per hour) and **Romania** ($1.04) as the lowest cost countries of the region, followed closely by **Russia** ($1.75). While low labor costs are not the only factor behind investment location decisions – productivity, infrastructure, a highly trained and educated workforce and material and energy costs (to name a few) also determine competitiveness – they are playing an important and increasing role for investment in these countries (particularly German investment). **Poland,** the largest country of the survey after Russia, takes second place in terms of expense at a mere $3.17 per hour. Concerning the "non-wage" component (i.e. benefits such as health insurance, paid leave and, most notably, social security) of the hourly rates, Poland and Hungary have the highest level of such costs as a per cent of direct wages at 80% and 84%, respectively, which reflect Western European practices (albeit at bargain levels).

...**Correction:** Fordham University Law School's *Seventh Annual Conference on Intellectual Property Law* will take place on **April 8 and 9, 1999** in Manhattan, not on April 9 and 10 as was reported in the January 1999 issue of EURECOM. For more information, please contact T. Scott Lilly at: tel (212) 636-6777, fax (212) 636-6984 or e-mail *Slilly@mail.lawnet.fordham.edu.*

MONTHLY BULLETIN OF EUROPEAN UNION ECONOMIC AND FINANCIAL NEWS

For additional information on any article in this issue, please write or telephone Christopher Matthews or Kerstin Erickson at (212) 371-3804.

EURECOM is also online at http://www.eurunion.org/news

Our e-mail address is: *eurecom@usany.eudel*

Please send a regular free copy of EURECOM to:

Name __________

Position __________

Organization __________

Address __________

Special Interests __________

EURECOM is published by Wouter Wilton, Director of Press & Public Affairs, the European Commission, 3 Dag Hammarskjold Plaza, 305 East 47th Street, New York, NY 10017. It is edited by Christopher Matthews. The contents of EURECOM do not necessarily reflect the views of the European Union's institutions. Any article may be reproduced without express permission. However, acknowledgement of the source and a copy of any material published would be appreciated.

Printed on Recycled Paper.

European Commission
3 Dag Hammarskjold Plaza, 305 East 47th St., New York, NY 10017
Telephone (212) 371-3804