

# ETLA

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### **EUROPEAN UNION AND UNITED STATES TRADE RELATIONS**

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**ABSTRACT:** Transatlantic trade relations between the European Union and the United States have evolved rapidly at the close of the 21<sup>st</sup> century. Alongside the benefits of free trade the relationship has been marred by trade disputes. The WTO arbitration and government and business initiated transatlantic dialogue have been unsuccessful at resolving these disputes. A trade war would have far-reaching consequences for EU-US relations. The US has shown signs of protectionism and there is a potential for tension within the EU regarding trade policy. To avert further escalation the WTO must show leadership. The importance of transatlantic trade disputes is largely exaggerated and with the recovery of the global economy the tension on EU-US trade will decrease.

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**TIIVISTELMÄ:** Yhdysvaltain ja Euroopan Unionin väliset kaupalliset suhteet ovat kehittyneet nopeasti 2000-luvulle mentäessä. Vapaakaupan tuomien etujen ohella Atlantin välisiä suhteita ovat kuitenkin häirinneet kaupalliset kiistakysymykset. WTO:n välitysyriytykset ja hallitusten ja liike-elämän alulle panemat neuvottelupyrkimykset eivät ole onnistuneet ratkaisemaan näitä kaupallisia kiistakysymyksiä. Kauppasodalla olisi vakavat ja kauaskantoiset seuraamukset EU:n ja USA:n välisille suhteille.

USA on osoittanut merkkejä protektionistisista toimista ja EU:n sisällä on nähtävissä mahdollisia kiristymisen merkkejä kaupallisissa suhteissa. Jotta estettäisiin suhteiden enempi vaikeutuminen, on WTO:n näytettävä johtavuutta. Atlantin välisten kaupallisten kiistakysymysten painoarvoa on suuressa määrin liioiteltu ja globaalitalouden elpyessä EU:n ja USA:n välisten kauppasuhteiden jännittyneisyys tulee vähenemään.

At the end of World War II the United States-Western Europe relationship became the fulcrum upon which the world economic system balanced. At the end of the millennium this relationship has again become the most important economic partnership in the world. The United States has been an economic hegemon throughout the post-war period and the European Union has become the largest single market in the world. The United States and the countries of the European Union account for over \$ 16 trillion of the world's GDP. The relationship between these two motors of the world economy has recently become famous for its trade disputes that give insight into state of this partnership.

This paper assesses the current state of the EU-US trade relationship at a pivotal time. A concise history of US-EU relations sets the background for the current problems. Following a description of some of the trade disputes plaguing transatlantic relations the current efforts of resolution are presented. The evaluation of these solutions leads to an examination of potential future threats to the transatlantic economic relationship according to the trends observed from the present situation.

## Background

Despite the modern transatlantic<sup>i</sup> economic relationships eventful past it is perhaps possible to claim that the integration of fifteen European states into the European Union has had the greatest effect.

In 1945 Europe and what was left of its economies lay in ruins while the United States war-time economy was booming. Europe became a prime market for the 'hot' US economy with the Marshall Plan. Though politically motivated this aid package initiated European recovery on the condition of open markets. Idealistically this was done to promote peace through interdependence theory but the genuine goal was economic profit as the US continued to export to Europe as it shifted to a peacetime economy. As the world polarized and the Cold War closed off Eastern Europe ties between the United States and Western Europe became stronger.

Europe also strengthened cross-national ties with the 1951 creation of a single market of the European Coal and Steel Community (ECSC) by Belgium, France, the Federal Republic of Germany, Italy, Luxembourg and the Netherlands. Though the ECSC was economically beneficial it was created with largely political undertones. The defeated Germany was to be constrained and integrated into a European framework. Over the course of the next four decades this movement towards single markets and liberalization of trade would evolve into the European Union involving fifteen countries.

As Europe grew stronger economically the US became less involved as its primary concerns in Europe were political and military. When the Soviet Union crumbled and the Cold War was won, the United States interests in the integrated Europe further diminished.

The election of President Bill Clinton in 1992 reduced attention to Europe as the US governments focus shifted to domestic issues. The primary international economic issues were the North American Free Trade Association and trade disputes with Japan. The weakening of

EU-US relations in the early 1990's was described by a trend of "transatlantic drift". Americans were not overly concerned or even convinced that the European experiment in integration was going to happen.<sup>ii</sup> Though the US government had always proclaimed stalwart support for the EU no concrete steps had been taken. American businesses with interests in Europe quietly prepared for the possible arrival of the Euro and watched with apprehension as new Directives and regulations took hold. In 1995, as a response to weakening links across the Atlantic the ambitious New Transatlantic Agenda was signed by EU and US representatives with hopes of promoting discussion and increasing trade.

In 1997 the financial crisis hit Asia. The United States and Europe looked across the Atlantic for markets to replace Asia's troubled economies. With no other comparable economies in the world the US-EU relationship became the pivot for economic progress<sup>iii</sup>.

The United States and the countries of the European Union share similar basic economic statistics. In 1997 excluding intra-EU trade the EU imported 17.1% and exported 19.6% of the world trade while the US imported 20.3% and exported 16.5%. This accounts for almost 40% of total world trade. In the same year the GDPs were \$ 8093,4 billion and \$7819,3 billion for the EU and US respectively. The two economic superpowers share the world's largest trading and investing relationship with daily transatlantic flows of around \$1 billion per day<sup>iv</sup>. Despite the large volume of transatlantic trade and the economic clout of these two actors the transatlantic relationship is best known in the media for its numerous trade disputes.

## The European Union in Theory and in Practice

The European Union is an experiment in trade theory. There are various debates concerning the necessity of monetary unions to complement economic unions that would be supplemented by political unions as discussed by Eichengreen<sup>v</sup>. The European Union established the Single Market and a monetary union with the aim of strengthening the European economy while governing by means of a limited government.

The creation of the European Union will also be beneficial to those outside the 'Euro-fifteen'. The appeal of a single market and currency to US businesses is clear. Rather than having to deal with the trade regulations and restrictions of 15 countries there will only be one set of harmonized standards to follow. The introduction of the Euro will aid US businesses as this will lower transaction costs as well as the costs associated with hedging and the risks encountered when dealing with fifteen different and unpegged currencies.

There was much speculation on the role of the integrated European economies in the global economy. The EU was expected to challenge the US economic hegemony as it consolidated and launched the Euro. The economies of scale, the Euro's challenge to the US The 'four freedoms' of the free movement of capital, labor, goods and services were designed to ensure a greater competitiveness.

The young EU has not yet accomplished all that theories had predicted it would do. The Euro has declined relative to the US dollar and the United Kingdom has opted to stay out of the

monetary union. The EU has adopted harmonized tariffs and regulations but in practice these have not always translated into open markets as the highly publicized trade disputes indicate.

## Problems in EU-US Relations

Over the past decade there have been tremendous changes that have deeply altered the relationship between the United States and what were formerly fifteen European states and now the economically integrated European Union. Despite the significant changes in US-EU relations the two economic superpowers have not developed new approaches to the transatlantic relationship. Instead as the importance of transatlantic ties increase US-EU dialogue has become narrowly focused on trade conflicts rather than new strategies or institutional development that would alleviate the necessary adjusting in the transatlantic relationship.

With increasing trade and interaction simple disputes over single commodities became trade conflicts backed by government policy. With these setting conditions it is no surprise that at the December 1998 summit the world's leading economies could only agree to consider new winemaking standards.<sup>vi</sup>

## Banana War

Bananas have been the cause of an ever intensifying trade dispute between the United States and the European Union since 1993. The EU and the US, the world leaders of free trade, have taken a dispute over bananas, a commodity which neither directly produces domestically, to negotiation and arbitration at the World Trade Organization and have subsequently imposed retaliatory duties of over \$190 million.

In 1993 the European Union adopted a single market trade policy favoring banana imports from former European colonies and other countries in Africa, the Caribbean and the Pacific (ACP) under the Lomé Treaty at the expense of Latin American countries. This was justified on the basis of economic aid or support for the weak banana export reliant economies.

In 1993 and 1994 following a complaint by Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela GATT panels found the burdensome EU banana regime GATT-inconsistent. The EU 'unofficially' accused the US of pressuring these Latin American countries into filing a complaint beneficial to US business interests.

Following no change in the EU regime The United States and four banana producing Latin American countries accused the EU of violating major provisions of the WTO. According to a US Trade Representative report the illegal EU banana policy has caused American companies Chiquita Brands Inc. and Dole Food Company to lose half of their business.<sup>vii</sup> Following a long process in May of 1997 the WTO ruled in favor of the plaintiffs stating that the EU banana regime was WTO-inconsistent. Following limited reforms the WTO arbitrator ruled that the regime was still WTO-inconsistent despite the EU's debates and appeals. The EU again failed to conform to the demands of the WTO and in December 1999 the United States formally asked the

WTO for authorization to proceed with retaliatory duties totaling \$520 million yearly against the EU. In April the WTO authorized the US to proceed with retaliatory sanctions to the amount of \$191,4 million. USTR Charlene Barshefsky stated in an April 19, 1999 press release. "Our action today redresses the longstanding imbalance in WTO rights and obligations and sends a clear message to the EU that protectionism has a price".<sup>viii</sup> Despite six years of discussion and retaliatory duties the issue is still far from resolved as the European Union's Council is currently once again reviewing its banana regime in order to conform to WTO rules and fulfill its obligations to ACP countries.

## Growth Hormone Dispute

There is an obvious conflict between EU and the US agricultural policy. The US agricultural policy's official goal is to increase the world's food security. The Clinton administration's policy attacks the EU position. This policy's official goals are to promote fair trade by reducing foreign export subsidies and trade distorting domestic supports, ensure that sanitary and phytosanitary standards are based exclusively on science and to help guarantee farmers and ranchers the use of safe modern technologies, particularly biotechnology, without fear of trade discrimination. This policy line leads to inevitable conflict with European agricultural policy characterized by the Common Agricultural Policy adopted in 1993, which includes \$60 billion in subsidies or 85% of the world's export subsidies, and a absolute ban on hormone treated meat imports.

The infamous hormone beef conflict is as much a debate over science as it is over trade. This is an example of sensitive and highly technical topic that has not been resolved despite WTO intervention.

Both European and American scientific studies claim that meat that is treated with natural or synthetic growth hormones is harmless to humans. The European Union however, disagrees to the point of maintaining a decade old policy of banning all imports ban of hormone treated meat. The US has accused the EU of violating its WTO obligations by maintaining the import ban without scientific evidence.

This trade dispute has escalated since its origins in 1987 at which time the European Union first announced a ban on all imports of animals or meat to which hormones had been administered effective in 1989. In 1988 this proposed ban was extended to all US meat by the Commission on the basis that the US did not have a residue testing program that complied with the EU Directive. As promised by President Reagan in 1987, 100% ad valorem retaliatory tariffs to the sum of \$100 million on EU exports took effect. Later that same year an agreement on interim measures allowing US producers to ship meat from cattle not treated with hormones to the EU postponed US tariffs. Following complaints by the US a WTO Panel, Appellate Body and Arbitrator found that the scientific evidence did "not rationally support the [EU] import prohibition"<sup>ix</sup>. In 1997, two years after the last WTO decision, another WTO panel concluded that the EU's ban was illegal under the 1995 GATT Agreement on the Application of Sanitary and Phytosanitary Measures. After repeated appeals a deadline of May 13, 1999 was set for EU compliance.

In a last minute study <sup>x</sup> the EU found a synthetic hormone used in American beef production to be "a complete carcinogen" and decided that it would maintain the ban on hormone treated beef. US Secretary of Agriculture, Dan Glickman, said that this repeated noncompliance threatened the credibility of the World Trade Organization<sup>xi</sup>. Following the WTO deadline, despite the EU Commission having sent the full scientific report to American authorities, the US submitted a request for compensation with the WTO equal to the losses of US beef producers of \$202 million a year, substantially less than the previously demanded compensation of \$950 million a year.<sup>xii</sup> After further delays the arbitrator awarded damages of \$116,8 million upon which the US imposed tariffs under Section 301 of the Trade Act. The European Union also claimed victory in the matter due to the reduced compensation and the sustained hormone beef ban.

## US Steel Import Curbs

Another type of EU-US trade dispute involves import barriers on steel. In the 1980s the European Union countries and the US, along with Japan, were the world's largest producers and exporters of steel. During the last decade third world countries have evolved from important steel markets to self-sufficient producers and significant exporters. While this industry was undergoing slow growth in the US and Europe, the fast growing China overtook Japan and the US to become the world's second largest producer of steel, behind the EU. Production also grew rapidly in South Korea, Brazil, India and Mexico.

When the financial crisis of 1997 hit Asia the EU steel trade surplus decreased from a 11.7 million tons in 1997 to one of just 0.5 million ton during the first 10 months of 1998 as steel imports from Asia jumped by 546%. The US saw a decrease in their trade balance of -7.4 million tons of steel. This situation quickly became a crisis within the steel industry as accusations of dumping met growing support for protectionism, particularly in the US.

Despite the jump in imports of Asian steel the EU has maintained a consolidated average tariff of 2.9% on steel. The US however took a path that the EU criticized loudly. Despite being illegal under WTO regime and receiving heavy criticism from the Secretary of Commerce Daly in July of 1999 the U.S. International Trade Commission (USITC) voted 5-1 to impose antidumping duties on imports of steel from France, Germany, Italy, Japan, South Korea, Mexico, Taiwan and the United Kingdom.

## Helms-Burton Act

The Helms-Burton Act and Iran and Libya Sanctions Act are an extension of a longstanding American anti-Communist and anti-terrorist foreign policy. This US legislation however is WTO-inconsistent and it came under attack from the EU as it allows the US to unilaterally apply sanctions on companies dealing with or within Cuba, Libya or Iran. The European Union requested a WTO panel to review the case but withdrew from the hearings following bilateral negotiations in which the US agreed to exempt EU companies from sanctions. Despite

maintaining its accusations of the illegality the EU was satisfied with this settlement reached outside of the WTO safeguarding its interests.

Though the above-mentioned disputes have attracted substantial media coverage there are more challenging EU-US trade related issues with greater consequences which have yet to be resolved. In 1995 the US Secretary of Commerce's and European Commission Vice President's survey of over 1400 EU and US businesses revealed that standards are the area in transatlantic trade relations could be most improved. According to Charles Rudolph of the US Department of Commerce the key to competitiveness for US firms in Europe was not tariffs or financing but timely information on standards.<sup>xiii</sup> The European Union as part of its integration into a single market has undertaken a mass harmonization of standards. This issue, however, has the potential to spark serious trade conflicts. In 1997 it was estimated that close to 50 percent of U.S. exports to the EU are subject to harmonization requirements for regulated products.

All of these disputes have hindered the potentially prosperous EU-US trade partnership. They are the result of incompatible policies, trade priorities and markedly business interests. The reason that they have escalated to these levels is due to ineffective institutions and an archaic notion of the transatlantic relationship.

These disputes, although all economically motivated and resulting in barriers to trade, have been framed very differently. The banana case is a conflict between the EU's obligations to the ACP countries and the WTO. Beef hormones, a food safety issue, is an especially sensitive topic in Europe following many recent food related health problems ranging from the mad cow disease in England to dioxin poisoning in Belgian chicken and cola contamination. The steel and Helms-Burton Act disputes result from US unilateral trade limiting action. Recently EU-US conflicts have escalated and become more frequent ranging from disputes over airplane hush-kits to genetically modified organisms. Despite the different approaches to these conflicts the common fact remains that the international trade regime's institutions have not been able resolve or even satisfactorily moderate the disputes.

Following the Uruguay round of trade talks and the formation of the WTO, largely by the economic superpowers, a method was established to resolve trade disputes. The US and the EU, however, have been unable to solve their differences through this process, which they essentially created. If bilateral negotiations did not solve the problem disputes were taken to the arbitrators resulting in a temporary solution in the form of trade sanctions and the loss of face and credibility of the chief organ of the international trade regime, the World Trade Organization.

To keep these disputes in perspective the EU Commission pointed out that trade disputes only involve an unsubstantial part (around 2%) of transatlantic economic relations and should not overshadow the positive aspects of this relationship.<sup>xiv</sup> In 1996 20,4% of American merchandise exports were destined for the EU while 19,6% of merchandise imports originated from the European Union. Total US exports in 1996 were \$873,8 billion of a GDP of \$7661,6 billion or about 11%. Trade, however is only part of the transatlantic economic relationship in which investment plays an important role. 1996 figures show that the EU invested \$372,2 billion in the US, or about 59% of total foreign direct investment in the US. Investment across the Atlantic stood at over \$700 billion in 1996.<sup>xv</sup> Despite the attention that these trade disputes have attracted from the media one can see that the figures involved are relatively small. Alarmists however claim that these disputes will lead to a trade war.



## Efforts to Improve Transatlantic Relations

Since the creation of the European Union the US-EU relationship has come under much stress as Europe has integrated, become stronger and launched a new rival currency. To counter a transatlantic rift came initiatives, agreements and forums promoting cooperation and dialogue in order to profit both sides of the transatlantic.

In 1995 the US and EU signed the New Transatlantic Agenda to prepare for the changes ahead. This ambitious project addressed many issues but stressed the maintaining of transatlantic dialogue at all levels and liberalizing the transatlantic trade partnership. Since this government agreement the private sector have initiated government supported discussions on trade. The Transatlantic Business Dialogue (TABD), for example, has promoted links between businesses and worked with government in shaping trade policy especially policy concerning standards.

The TABD pushed Mutual Recognition Agreement (MRA) of 1997 was a major breakthrough for US-EU trade affecting over \$47 billion in trade. This US and EU signed agreement was to increase efficiency in transatlantic trade by harmonizing standards for medical devices, pharmaceuticals, recreational craft, telecommunications and electrical equipment. This harmonization allows a product to be tested once and be approved in both the EU and the US. Both governments involved claimed that this breakthrough would not have been possible without TABD. Previously the TABD had been successful at streamlining European taxation policy thus cutting costs and increasing trade. In 1998, the US and the EU signed an Agreement on "Positive Comity" in Antitrust Enforcement. This agreement supports both governments' commitment to competitive markets.

Since the successes of TABD the Transatlantic Economic Partnership (TEP), Transatlantic Labor Dialogue (TLD) Transatlantic Legislators Dialogue (TALD), Transatlantic Environmental Dialogue (TAED) and Transatlantic Consumer Dialogue (TACD) have been launched with the goal of promoting cooperation and preventing conflicts. The effectiveness of these forums ranges from diplomatic niceties to veritable task forces.

## Results of Transatlantic efforts

The billions of dollars of transatlantic trade provide a reasonable motive for business leaders and governments to put their efforts into smoothing EU-US relations. These groups have focussed on harmonizing standards and devising so-called early warning systems of potential trade conflicts reducing efficiency and trade. Unfortunately these informal dialogues between top business executives can not resolve existing trade conflicts, disputes in which no common ground exists or sensitive trade issues. Executives are unlikely to forgo profits for the sake of their transatlantic colleagues and the US-EU relationship. A legislators' dialogue will not reverse protectionist policies that defend their constituents' jobs.

Some disputes have been 'temporarily' resolved and this is only after years of deliberations. The EU has been appeased with 'The Understanding' concerning the Helms-Burton Act. The US

has retaliated with the permission of the WTO against the EU in the infamous banana and hormone beef cases while the source of the conflict remains unresolved. This trend of postponing deadlines and paying retaliatory duties to avoid policy changes will only work for so long as new conflicts arise and further stress EU-US relations and the WTO.

A fundamental weakness of the current trade regime is the WTO. The structure of the WTO was designed to keep the arbitration process transparent. Unfortunately this has left the organization without any teeth. The European Union has delayed arbitrators' decisions by repeatedly appealing cases only to finally ignore the decisions made by WTO arbitrators. This in turn has launched another process by which retaliatory tariffs can be imposed. Even when the EU's policies have been found WTO-inconsistent and have been 'fined' the EU has still claimed victory in the trade conflict and has not changed its policies. In the banana dispute the process from original complaint to WTO-authorized retaliatory duties has lasted the lifetime of the WTO and the issue still remains unresolved.

The United States has been a stalwart proponent of the organization despite being a defendant in the most number of cases in front of the WTO. Instead of changing its WTO-inconsistent policies it has settled many cases outside of the WTO, as in the case of the EU and Helms-Burton Act.

The organization has never seemed as weak as in the second quarter of 1999 when it was not even able to name a director-general by the required consensus. While the technically strong WTO is ready for new round of talks questions remain about the leadership. The current scenario is detrimental to the international trade system. The WTO is discredited every time a member refuses to abide by its obligations and the organization seems unable to respond.

## Future transatlantic troubles

To date no solutions have resolved the quarrels plaguing EU-US trade relations. Though the United States and the European Union area have been allies and economic partners for over half a century predictions of a trade war resulting from these disputes have been made. Although there are many arguments to counter this claim there are new threats to the transatlantic relationship.

## WTO

It is clear that the current role of the WTO is far from ideal and that there is room for further development. EU Vice President Sir Leon Brittan recently outlined the need for further trade talks. He deemed the following as threats to liberalization: the Asian financial crisis, protectionist tendencies (e.g. US) and skepticism about the benefits of globalization<sup>xvi</sup>. The European Union has been a major proponent of this round and has proposed several agenda items. Among these the EU wishes to discuss agricultural issues and third world market access<sup>xvii</sup>, which address the hormone and banana conflicts respectively. The United States' has shown its support for the round by hosting the talks.

As plans were made for the Millennium Round of WTO talks, Finland, the president of the EU until the end of 1999 hoped for an efficient and short three year round that would have resulted in a stronger WTO and multilateral rules-based system. This goal seemed plausible as the WTO despite being headless since May 1999 finally resolved its leadership dilemma by placing two people in the director-general's post for three year periods each starting September 1999.<sup>xviii</sup>

The high hopes for the Millennium Round started to fade before the talks even commenced as an agenda could not be agreed upon. No significant trade negotiations occurred but Sir Britan's third threat to free trade was clearly voiced. The skeptics of free trade became most influential factor in the Seattle talks. The attempted Millennium Round will be best remembered for the violent demonstrated and the rioting in Seattle by various groups opposed to the WTO and free trade. These halted the talks before they ever had a chance to begin. Despite the failure of the first attempt of the Millennium Round to advance free trade the world's political and economic leaders met in Davos, Switzerland at the World Economic Forum. Here the heads of many governments reaffirmed their commitment to free trade and further talks of the WTO despite the spreading and intensifying backlash against globalization.

Europe and the US built the world economic system by first creating GATT and the WTO thereafter. At the end of the 1990s the US was the only area experiencing substantial economic growth and still was unable to follow the WTO goal of trade liberalization it is unlikely that transition economies or the Asian economies even though recovering from their recent crises will be able to.

The international trade regime desperately needs a successful 'Millennium Round' level meeting. The WTO needs to give momentum to the international trading system to avoid a stall in the liberalization movement. According the bicycle metaphor, to give the push to advance free trade so it does not fall over. This is the opportunity for this organization to claim its role in the international system as a mediator and not merely a bureaucratic approval mechanism for retaliatory tariffs.

## Asia

In the 1980's the world was dominated by the US and in turn its relationship with Asia, especially Japan. Although EU-US trade disputes existed at the time the focus was predominantly on the US-Japan dyad, particularly from the US perspective. It was the United States and Japan that were claimed to be on the brink of a trade war resulting from import quotas and duties on cars and market access to Japan among various other trade conflicts.

In the 1990's the integrated EU climbed to take the position of one of the two largest economies in the world alongside the US. It was clear that these two economies would interact more with each other as well as Asia as the global trend of globalization and increased trade continued. With the financial crisis the Asian Tigers and particularly Japan's economies slumped leaving the two remaining economic superpowers in a virtual vacuum. This increased the importance of EU and the US markets for each other. Unfortunately as the volume of trade increased so did the level of trade disputes.

The Asian crisis not only placed increased emphasis on the transatlantic relationship but it also strained the EU's and US' commitment to liberalization. 1998 US exports to Japan dropped over 13% from the previous year while US balance of trade deficit reached record levels. In the same year the EU's trade deficit with Japan grew by 43%, compared with 1997.<sup>xix</sup> While the Asian economies struggled to recover and trade deficits continued to grow a rise in protectionist tendencies becomes inevitable. The US has succumbed to this pressure and protected domestic steel while the EU, with much less Asian trade, has maintained its freer trade policy and even criticized the US for the import curbs. These essentially American issues strongly affect the EU as protectionist measures were not only taken against Asian producers of steel but also members of the EU.

The increase in US protectionist tendencies has resulted in unilateral actions that are not limited to sheltering American industries from dumping or illegal competition. Despite a booming economy the steel industries lobbying success has launched other industries into seeking protection. For domestic political reasons quotas and tariffs have already been placed on lamb imports from Australia and New Zealand though the US hardly produces any lamb of its own. Mexico, Venezuela and Saudi Arabia are planning retaliatory measures in response to US threats of anti-dumping duties on oil. All of these potential trade disputes affect the EU as in the case of steel these exports were deflected from the US to the EU's still open markets. The Clinton Administration is yielding to protectionist political pressure under the guise of salvaging the US balance of trade. If the US continues to pursue protectionist trade policy, which is the trend in an election year<sup>xx</sup>, further trade disputes and rifts in the transatlantic relationship will be hard to avoid.

Despite the rise in protectionism in the United States there is strong support amongst Americans for the inclusion of China in the World Trade Organization. This rapidly evolving country is a major economic partner of the US and as Clinton outlined in his speech at the World Economic Forum in Davos China's inclusion in the international trade system will hopefully bring stability in the region as the future of China and its economic implications at the moment is quite unpredictable. The further opening of Chinese markets, along with the complete recovery of the Asian NICs, could potentially diminish the importance of European markets to the US.

## US role in world economy

In 1990's the US has remained the constant in international trade relations with sustained growth and open trade despite an increasingly negative balance of trade. The US has maintained an annual average GDP growth rate of 3.1% since the second quarter of 1991 despite the 1994 bond market crash, the Mexican crisis of 1994-95 and the emerging market crisis of 1997-98.<sup>xxi</sup> After 31 quarters of solid expansion an eventual slowdown is expected. Yet at the turn of the millennium despite a booming US economy there is a growing tide of protectionism. A study by the Chicago Council on Foreign Relations revealed that 49% of Americans favor tariffs<sup>xxii</sup>. This begs the question of what will happen to US trade policy when the economy finally does slow? Already in the second quarter of 1999 the US GDP growth has slowed to an annualized rate of 2.3% after rising 4.3% the previous quarter and the measure of American Consumer Confidence from The Conference Board decreased for the first time in nine months.

If the transatlantic relationship degenerates into a trade war it is the US that has the stronger arsenal. The US has already won the approval of the WTO to impose over \$300 million in retaliatory tariffs against the EU. The reactivation of Provision 301 of the 1974 Trade Act by the Clinton Administration in March of 1999, due to protectionist pressure from congress, far outclasses the bureaucratic WTO's tariff authorization. This legislation, known as 'Super 301' allows the US Trade Representative not just the right to the investigation of particular good but the trade practices of an entire country. Originally designed to be used against Japan 'Super 301' was repealed by the US upon joining the WTO.

Presidential elections in November of 2000 will determine the next administration and therefore the commitment to free trade and the WTO at the highest government level. At the end of January 2000 the leading Democrat candidate, Al Gore, and the leading Republican contender, George W. Bush Jr. both have made statements supporting free trade. If the Democratic control over the White House continues one can expect that a trade policy congruent to that of the Clinton administration would be followed. While campaigning George W. Bush was quoted campaigning in Iowa as 'being a free trade president'. Neither candidate, though both supporters of free trade, has elaborated on international trade issues. Interpretations of the candidates' commitments have ranged from increased power and voice to the WTO to free trade for US exports only.

The official position of the past Presidents' administrations on European political and monetary integration has been supportive. This rationale behind this is that Europe will be stronger. Former Treasury Secretary Robert Rubin said "It has been our view that anything that benefits Europe economically is good for the United States." At the time there was not much economics supporting this largely political stance. The United States has only recently become interested in the European Union and the European Monetary Union. A 1996 paper concluded that to date the government, academia, media and even businesses, had essentially ignored European integration and its consequences.<sup>xxiii</sup> This view has changed radically within the last few years with the changes in the transatlantic relationship.

The EU is creating its role within the international economic system until now dominated by the US. The two trade blocs are essentially establishing the rules of this new relationship that is been weakly governed by the WTO. In line with theories suggested by Dixit (1987) the EU and US are two blocs that will have to interact repeatedly in order to sustain a cooperative relationship. One can assume number of disputes and the inability for the two blocs to solve them that this explicit or tacit cooperation has not yet been achieved and only will with the development of the transatlantic relationship. As an extension of this theory when the banana dispute is resolved not only will this specific technical problem be resolved but a precedent will have been set for settling disputes involving conflicting obligations. With the settlement of specific trade conflicts larger trade issues are resolved thus progressing the transatlantic relationship.

## Fragmentation of the European Union

The fragmentation of the union of European states has not played a major part in trade policy to date. Until now the EU nations have stood together behind trade policy despite the fact that the

benefits of protectionism are not equally distributed and neither are the consequences. This has the potential to change if trade disputes continue to be temporarily settled by WTO approved retaliatory tariffs. In the beef hormone dispute countries that are not the main beneficiaries of the ban on US beef imports are paying the price for protection through lost business and import duties on exports destined for the US due to retaliatory tariffs. Countries like Finland, with relatively insignificant beef production, are affected by WTO authorized retaliatory duties on paper products that are a core of the country's economy. Retaliatory tariffs may target any sector within the offending party therefore making every industry in every EU country accountable for EU trade policy whether it benefits them or not. This of course is designed to exert the maximum amount of pressure to change the offending policy with the allotted amount of tariffs.

Therefore incentive to defect from certain trade policies is real. As a result of the so-called banana war the US published a list of retaliatory tariffs on EU exports in which cashmere was included. This largely Scottish-based industry's products would have become noncompetitive in the US, the major lucrative market, due to a 100% ad valorem tariff. Only after high-level meetings between Scottish Secretary Donald Dewar and President Clinton cashmere was spared. In the trade dispute involving American hormone beef Britain was spared WTO approved retaliatory tariffs after it officially opposed the EU's import ban. The French government suggested that the EU compensate the producers of products heavily hit by tariffs. They "are victims of a decision taken at a European level, so we should see if Europe can support them" said French agriculture minister Jean Glavany. Not only do these cases illustrate the inefficiency of the current system but also the incentive for unilateral action, or defection from EU policies, for national gain. In the future this may well pose restrictions on EU trade policy due to the differences between the fifteen members economies EU countries may not support a trade policy which supports a small interest if it will result in retaliatory action against them.

In this respect the United States has the advantage over the recently integrated EU nations. As diverse as the United States may be it has one government involved in international trade issues not fifteen attempting to act in unison.

Different institutional conditions also affect the relationship between member states and the central bank in the United States and the European Union<sup>xxiv</sup>. In the US the Federal Reserve System follows a policy that is beneficial to the country as a whole but it is accountable to the states. In the US the Congress has the power to limit the Federal Reserve's autonomy through legislation. If the European states have grievances with the European Central Bank a statute can only be changed through the re-negotiation of an international treaty.<sup>xxv</sup>

## Importance of Disputes

Contrary to media reports the transatlantic economic relationship is continually strengthening. Transatlantic direct investment has grown at a consistent rate and has nearly doubled in the last decade. The EU and US remain each other's most important trading partners. To suggest a full-blown US-EU trade war involving unilateral WTO-inconsistent trade policy is to ignore the scope of the current conflicts.

As the EU Commission reminded the US earlier, the sum of trade involved in transatlantic disputes is less than 2% of total transatlantic trade. Of these current disputes most involve trade practices that are disapproved of not only by the plaintiff state but also by the WTO, which both the EU and US strongly support. To complain about WTO-inconsistent trade regimes that coincide with national interests is natural. There is also much pressure to do so. In the infamous banana dispute one of the two major companies affected by the EU regime, Dole Fruit Co., has annual total revenues of over \$4,4 billion.

Though some industries have had particularly strong lobby groups that have influenced trade policy neither the US nor the EU have taken WTO-inconsistent unilateral action that would seriously jeopardize transatlantic trade relations. With mounting protectionist pressure in the US and the failure of the Millennium Round the potential for serious disputes exists. These disputes however are unlikely to involve a significant enough portion of transatlantic trade to be classified as a trade war. For the time being as neither party has other trading partners that match the EU or US in size neither can afford a troubled transatlantic economic relationship.

Though immeasurable in economic terms both the leaders of the United States and the European Union have demonstrated a commitment to free trade and the WTO, most recently at the World Economic Forum in Davos, Switzerland. Until now however this commitment has been largely political in nature. These words will not be enough to restart a new round of WTO talks at this very crucial stage or reduce transatlantic frictions unless they are followed by matching action which neither party has been able or willing to do thus far.

## Conclusion

The transatlantic relationship is complex. The US, the most powerful country, is interacting with a relatively new collation of states represented by a new system of government, which is not yet fully implemented. It was no surprise that the economic standards, systems and practices would not mesh immediately. The situation however was made worse by the inevitable political intertwining into economic policy as trade disputes arose. The global economic situation made this chaotic relationship the pivot for the upholding of free trade exaggerating the importance of relatively small conflicts.

The transatlantic strain once publicized as a threat to liberalization is easing in the new millennium despite the WTO's failure to hold successful talks. The growth of the global economy has taken the focus off of EU-US trade. This has by no means resolved trade disputes but has given the parties involved time to develop policies and standards that could potentially harmonize transatlantic relations. Though still critical the WTO has been given time to plan for a successful round with less urgency. The EU has the opportunity to fully instate its economic policies. The United States government will find other trade issues to tackle. Meanwhile, transatlantic trade will continue to expand and push free trade as businesses adapts to the transatlantic part of the global economy and the ratio of disputes to overall trade continues to diminish.

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<sup>i</sup> The term transatlantic will henceforth be used to refer to United States and the European Union

<sup>ii</sup> Karczmar, Mieczyslaw. *The U.S. and the European Monetary Union: What do the Americans think about EMU?* in EMU Watch, July 29, 1996. Deutsche Bank Research.

<sup>iii</sup> Bergsten, Fred. *America and Europe: Clash of the Titans?* in Foreign Affairs, March/April 1999 vol. 78 number 2. reprinted by Institute for International Economics <http://www.iie.com/TESTIMONY/titans.htm>

<sup>iv</sup> The European Union and the United States: allies with global responsibilities December 1998 <http://europa.eu.int/comm/dg01/infus2.htm>

<sup>v</sup> Eichengreen, Barry. *A More Perfect Union? The Logic of Economic Integration*. in Essays In International Finance No. 198, June 1996, Princeton University, Princeton, NJ. 1996

<sup>vi</sup> Bergsten, Fred. *America and Europe: Clash of the Titans?* in Foreign Affairs, March/April 1999 vol. 78 number 2. reprinted by Institute for International Economics <http://www.iie.com/TESTIMONY/titans.htm>

<sup>vii</sup> The United States Mission to the European Union. Date: 03/18/97 *Outlines "fallacies" in EU "fact sheet"* <http://www.useu.be/archive/falla.html>

<sup>viii</sup> The United States Mission to the European Union, Date: April 20, 1999 *WTO AUTHORIZES U.S. TO RETALIATE IN BANANA DISPUTE* <http://www.useu.be/issues/wto420.html>

<sup>ix</sup> <http://www.useu.be/issues/chron226.html>

<sup>x</sup> Scientific Committee On Veterinary Measures Relating To Public Health released a study on April 30, 1999 which claims that the growth hormone 17 $\beta$ -oestradiol is a carcinogen

<sup>xi</sup> Statement by Agriculture Secretary Dan Glickman on the EU's Failure To Comply with WTO Rulings on the Beef Hormone Ban Release No. 0213.99 FAS PR 0154-99 May 14, 1999 [http://www.fas.usda.gov/scripts/PressRelease/pressrel\\_dout.idc?PrNum=0154-99](http://www.fas.usda.gov/scripts/PressRelease/pressrel_dout.idc?PrNum=0154-99)

<sup>xii</sup> The European Union in the US: *HORMONE BAN: EU IN LINE WITH WTO OBLIGATIONS, SAYS CHIEF EU ENVOY IN WASHINGTON* <http://www.eurunion.org/news/press/1999/1999027.htm>

<sup>xiii</sup> Charles Ludolph, Director, Office of European Union and Regional Affairs, U.S. Department of Commerce, Chairman, U.S. Interagency Working Group on EU, Standards and Regulatory Issues, IN *NIST Special Publication 891 (1997 Edition) STANDARDS SETTING IN THE EUROPEAN UNION---Standards Organizations and Officials in EU Standards Activities* <http://ts.nist.gov/ts/htdocs/210/216/mramain.htm>

<sup>xiv</sup> European Parliament Resolution on the Transatlantic Economic Partnership and EU/US – trade disputes, especially hormones, bananas and hushkits Brussels, 4 May 1999 <http://europa.eu.int/comm/dg01/0605hormb.htm>

<sup>xv</sup> <http://www.useu.be/Factfig/Factfig.html>

<sup>xvi</sup> Directorate General for Trade. "Why do we need a New Round?" <http://europa.EU.int/comm/dg01/newround/0107slb.htm>

<sup>xvii</sup> *ibid.*

<sup>xviii</sup> The Economist p 76, July 24<sup>th</sup>, 1999

<sup>xix</sup> Directorate General for Trade. *The EU and Japan: leading economic powers and important trading partners.* <http://europa.eu.int/comm/dg01/eujapen4.htm>

<sup>xx</sup> The Economist July 17<sup>th</sup> 1999, p. 50

<sup>xxi</sup> BNP Economic Newsletter. April 1999

<sup>xxii</sup> American Public Opinion and US Foreign Policy 1999, published by the Chicago Council on Foreign Relations, USA

<sup>xxiii</sup> Karczmar, Mieczyslaw. *The U.S. and the European Monetary Union: What do the Americans think about EMU?* in EMU Watch, July 29, 1996. Deutsche Bank Research

<sup>xxiv</sup> Gianaris, Nicholas V.. *The North American Free Trade Agreement and the European Union*. (Praeger: London, 1998)

<sup>xxv</sup> Eichengreen, Barry. *A More Perfect Union? The Logic of Economic Integration*. in Essays In International Finance No. 198, June 1996, Princeton University, Princeton, NJ. 1996