A New Transatlantic Trade War?

Six months after the Doha agreement on a new round of talks to liberalise world trade, tension is mounting between the EU and the US, the world's two major trading powers, giving rise to fears of a full-blown transatlantic trade war and a new wave of global protectionism. The contributors to this Forum look at the causes of, and possible remedies for, this development, taking economic, legal and political aspects into consideration.

Richard Senti'

Issues Surrounding the US-EU Steel Conflict

Faced with the misery and destitution of the war just ended, the founding fathers of the new system for regulating world trade found in their Proposal for Expansion of World Trade and Employment (November 1945) that: "The fundamental choice is whether countries will struggle against each other for wealth and power, or work together for security and mutual advantage." Any new conflict arising between the major trading partners confronts them anew with this choice. This article on the international steel dispute which broke out in early March aims to sketch the development of the trade feud over time and then, to critically assess the procedures chosen by the trading partners and the decisions they have taken, questioning these in the light of the world trading rules currently in operation.

Timeline

5 June 2001: US President George W. Bush announces a comprehensive initiative to respond to the challenges facing the US steel industry. As part of that initiative, President Bush directs the US Trade Representative Robert B. Zoellick to request the US International Trade Commission (ITC) to initiate an investigation under section 201 of the Trade Act of 1974 into the effect of steel imports on the US steel industry.

22 June 2001: Trade Representative Zoellick calls upon the ITC to clarify "whether certain steel products are being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof."

7. December 2001: The ITC announces recommendations and views on remedy in its global safeguard investigation involving imports of steel, promising to issue its final report by the end of the month.

20 December 2001: The ITC concludes from its investigation that certain steel products "are being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or threat of serious injury, to the domestic industries producing like or directly competitive articles." The Commission proposes the establishment of protective tariffs of up to 20% of an imported product's price, for a four-year period.

5 March 2002: President Bush, on the basis of the ITC report, proclaims safeguard measures in the form of a tariff rate quota and an increase in duties on imports of certain steel products. The Annex to the Steel Products Proclamation, over 40 pages long, lists the protective tariffs, ranging up to 30%, applying to specific steel product types. The president reserves the right "to reduce, to modify or to terminate" the safeguard measures if certain conditions are fulfilled.

6 March 2002: The EU Commission puts forward a four-point programme in response to the United States' decision: 1) The EU will call upon the World Trade Organisation (WTO) to condemn the United States. 2) It will consider safeguard measures of its own against diverted imports from third countries. 3) The EU challenges the USA to propose what measures it will take to compensate injured parties and, if it fails to make any concessions: 4) Punitive tariffs will be applied to certain US products. The WTO confirmed the receipt of the EU's complaint on 7 March.

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20 March 2002: The US safeguard measures come into force for a four-year period.

20 March 2002: Under the auspices of the WTO, consultations take place between the United States and the EU, Brazil, New Zealand, Japan and South Korea. The negotiations show no immediate signs of success. If the consultations fail to produce any satisfactory result within 60 days, the EU is entitled to call for a WTO panel to be appointed.

22 March 2002: The EU compiles a list of 300 US products that it currently imports. These are the products that would be subject to punitive tariffs if the United States persisted with its measures to protect the steel industry.

27 March 2002: The EU resolves to apply an additional tariff of 15-26% on any steel imports from third countries that exceed the average import level for the last three years by more than 10%.

3 April 2002: The EU's safeguard measures against imports from third countries come into force.

19 April 2002: The EU publishes a proposed Council Regulation which would impose 100% punitive tariffs on certain US goods from 18th June 2002 (the so-called "short" list providing customs revenues of €377 million), to be followed by tariffs of 8-30% following a condemnation of the United States by the WTO (the "long" list with prospective customs revenues of €626 million).

17 May 2002: Japan decides to impose 100% tariffs on steel imports from the USA worth $4.88 million as of 18 June.

Unsolved Procedural Issues

Without presuming to judge the propriety of the procedures adopted by the disputing parties, the following will nevertheless highlight a number of procedural issues it might be interesting to discuss.

The US Trade Representative's letter requesting the investigation and the ITC's interim and final reports all avoid any mention of consultations between the trading partners under the terms of Article 3 (1) of the WTO's Agreement on Safeguards. Though not necessarily at government level, prior consultations are in fact said to have occurred between the trading partners.

The call for consultations made by the EU and other WTO members immediately after the announcement of the United States' safeguard measures, and their initiation of WTO dispute settlement procedures, is in accordance with the organisation's Agreement on Safeguards and the Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding). However, Article XIX (2) of the GATT states that a resolution such as that made by the EU, to apply quotas to third-country imports without prior consultation, beyond which supplementary tariffs will be imposed, can only be justified "in critical circumstances, where delay would cause damage which it would be difficult to repair". Whether or under what circumstances this might actually be the case is a difficult question to answer. Consultations with the parties affected are required to produce satisfactory evidence of likely "damage which it would be difficult to repair", so it is up to the EU to present a convincing case in this respect.

A problematic item in procedural terms is the EU's Council Regulation imposing punitive tariffs on US merchandise. Article 22 of the WTO Dispute Settlement Understanding stipulates that a party to a dispute may not seek the Dispute Settlement Body's permission to take counter-measures unless the Body has already made recommendations and decisions and these have failed to be fulfilled within a reasonable period of time. The author is not aware of any dispute managed by the WTO in which the panel or any other body resorted to by a complaining country has agreed to counter-measures being taken before proceedings have got under way. The United States has already charged the EU with acting in contravention of WTO rules, stating that a WTO decision must be taken before retaliatory, measures can be contemplated and that one party cannot act "as judge and jury" at one and the same time. It is fair to assume that the disputing parties' actions and reactions seen in recent weeks are at least to some degree intended as no more than posturing. However, aware that it only takes a small spark or flame to start a devastating blaze, representatives of German industry in particular (The Association of German Chambers of Industry and Commerce - DIHK; The Federation of German Industry - BDI; The Federal Ministry of Economics) have been urging moderation, calling on the EU Commission to "put paid to [this dispute] flexibly and constructively, without damaging transatlantic cooperation as a whole" (DIHT press release).

Legal Issues of Substance

Overcoming the differences between the United States and its foreign steel suppliers in the current dispute will also entail resolving a number of substantive issues. The main such issues concern

proving that imports are a source of "serious injury" and/or a "threat of serious-injury" to US manufacturers, which involves establishing a causal link and, secondly, the problem of selectivity (i.e. departures from the "most-favoured-nation" principle).

Article XIX of the GATT, the WTO Agreement on Safeguards and the US Trade Agreement all concur that safeguards may be deployed "if... any product is being imported ... in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products ..." The WTO defines serious injury as a "significant overall impairment in the position of a domestic industry", while a "threat of serious injury" is understood to mean a threat "based on facts and not merely on allegation, conjecture or remote possibility". On the basis of usage in US legislation, a distinction needs to be drawn between the term "serious injury" as used by the WTO and "major injury". The term "serious" is used when the injury concerned is one among other forms of injury occurring and, though significant, it is not the most significant of them. In contrast, a "major injury" would be the most significant among them. Thus the term chosen by the WTO assumes that, though excessive imports are injurious or pose the threat of injury to domestic producers, there may well be other factors contributing to the damage or threat besides the excessive imports.

Proving damage is always difficult on the basis of economic statistics. Depending on how products are grouped (i.e. precisely which products a category includes or excludes) and whether a case is made in value or volume terms, vastly different conclusions can be drawn. The ITC, for example, points out that the total value of steel imports into the United States has grown by 25% in the last five years, from $10.2 to $12.8 billion, whereas the EU Commission calculates that the volume has remained virtually unchanged at 28 million tonnes. The discrepancies between interpretations are even greater for specific product groups. Looking at the same five-year period, the ITC identifies some product groups (such as carbon and alloy pipe and tube) showing growth of a little over 55% while imports of others (e.g. carbon and alloy flat products) grew just under 5%. In other words, depending on how categories are defined there is ample scope for "creative" grouping. All in all, the ITC defined 33 product groups, among which it found twelve groups for which imports were so excessive "that they are a substantial cause of serious injury or threat of serious injury".

Another issue which remains unresolved in the present dispute over steel is the justification for selectivity. Without any further explanation, item 11 of the US proclamation states that the safeguards will apply to imports from all countries with the exception of Canada, Mexico, Israel and Jordan. According to a letter by Robert B, Zoellick, the exception for the two fellow NAFTA members Canada and Mexico is attributable to President Bush, who used the phrase "products from all sources other than Mexico and/or Canada" in his letter of instruction. The ITC then added its own proposal "that none of the additional tariffs or tariff-rate quotas apply to imports from Israel, or to any imports entered duty-free from beneficiary countries under the Caribbean Basin Economic Recovery Act or the Andean Trade Preference Act". Referring to the US-Jordan Free Trade Area Implementation Act, the ITC recommended that none of the additional tariffs be applied to imports from Jordan. In contrast to the United States, which grants preferential treatment to its treaty partners, the EU has evidently chosen to take no heed of its existing trade agreements. Switzerland and Norway, which have had a free trade agreement with the European Coal and Steel Community (ECSC) since 1972 expressly forbidding tariffs on exports or imports, will be subject to the same EU punitive tariffs as all other countries.

There are insufficient precedents to clarify the extent to which the most-favoured-nation (MFN) principle must be adhered to when safeguards are applied, or whether exceptions may be made to honour specific free trade agreements. Proponents of upholding the MFN principle base their case on the first sentence in the interpretational terms of the article on safeguards contained in the Havana Charter which never came into force. These state: "It is understood that any suspension, withdrawal or modification ... must not discriminate against imports from any member..." However, the proponents of selectivity go on just one sentence further in the same interpretational passage, stating "... that such action should avoid, to the fullest extent possible, injury to other supplying member countries". This, without doubt, will be one of the issues that need to be resolved in the WTO's dispute settlement proceedings.

The preference granted to developing countries in item 11 of the US proclamation will not, in principle, give grounds for differing views as the terms stipulated by the United States comply with Article 9 of the Agreement on Safeguards: "Safeguard measures shall not be applied ... as long as its share of imports

of the product concerned in the importing Member does not exceed 3 per cent, provided that developing country Members with less than 3 per cent import share collectively account for not more than 9 per cent of total imports of the product concerned." However, one issue that may arise in this context is how exactly the term "developing countries" should be defined.

Whether the steel conflict can be brought to a mutually satisfactory solution in the months ahead - and if so, how - will be very significant for the further development of the world trade system as we know it today. This dispute not only concerns an important traded good, but it also involves two trading partners who play the role of vanguard in the on-going development of a world trading order.

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Transatlantic Trade Under Fire

The United States is by far the most important trading partner of the European Union, taking nearly one fourth of its exports and supplying one fifth of its imports. The EU, for its part, is the second-largest trading partner of the USA, "sandwiched" between Canada and Mexico (the two other NAFTA members), each of which accounts for roughly one fifth of US exports and imports. Among the trade flows between the world's largest regions (East and South Asia, North America, Western Europe), the transatlantic one, comprising the trade between the NAFTA area and the European Economic Area (including the EU and EFTA states), is the second-biggest flow (with one twelfth of total world trade) after transpacific trade between North America and Asia (with one tenth of total world trade). If interregional trade is more strictly considered in terms of bilateral trade among countries or political entities, trade between the USA and the EU is the largest item by a wide margin. As shown in Figure 1, it is almost twice the value of US-Japanese trade (the second-largest bilateral interregional trade flow) and more than three times as large as the EU-Japanese flow (the third-largest one).

Expanding Transatlantic Production Networks

In the field of foreign direct investment (FDI), EU-US economic links are even closer than in the area of foreign trade. The US economy has gained ever-growing significance for both outgoing and ingoing EU FDI flows. In consequence, almost 50% of the FDI stocks controlled by EU companies in third countries are located in the USA while even 55% of third-country controlled FDI within the EU originates in the USA. Conversely, EU member states combine nearly two thirds of total inward FDI stocks in the USA (as against less than 60% a decade ago) and 45% (43%) of outward US FDI. In a global perspective, bilateral FDI\ between the EU and the USA clearly dominates FDI links between the world regions (Figure 2). Transatlantic direct investment and trade flows are also closely interwoven and complement (rather than substitute) each other. For example, US subsidiaries in the EU undertake about one fifth of total EU trade of manufactures with the USA (more or less evenly distributed between exports to and imports from the USA) while EU subsidiaries in the USA are responsible for almost one third of US manufacturing imports from the EU and one eighth of US manufacturing exports to the EU. Most of this trade is intra-company supplies of parts and components for further processing. These shipments have grown faster than at-arm's-length sales among unrelated companies and thus more quickly than total EU-US trade. Expanding production networks between the EU and the USA also involve a growing overall economic significance of each other's companies in the respective host economies. For instance, affiliates of European firms in the USA and American owned subsidiaries in the EU now account for approximately one tenth of total US and EU employment in manufacturing respectively.

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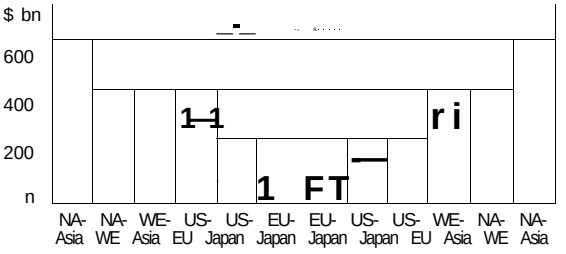
Implications for Trade Policy

These developments have implications for trade policy. Protectionist trade measures could in particular work to disrupt the production networks evolving across the Atlantic and thus harm economic welfare. An econometric analysis of transatlantic commerce shows that intra-firm trade between the EU and the USA declines with tariff and non-tariff barriers to trade.[1] The same has also been shown to hold for trade flows in general.[2] The FDI-deterring effects of a defensive trade policy stance appear to be much stronger than any incentives it may create to "jump" tariffs. This is not to say that the latter effect is totally irrelevant, witness current efforts of Arcelor SA, the Luxembourg-based largest steelmaker in the world, to buy US steel mills after the recent imposition of tariffs on imported steel in the USA. However, the steady increase of EU-US cross direct investments, and of the related sales of each other's subsidiaries, in the last two de,cades,.which on balance were a period of substantial transatlantic trade liberalisation, is clear evidence of a positive correlation between FDI and liberal trade policy in this geographic area.

On the whole, the EU-US trade and investment relationship is still a relatively liberal one, where state interventions that distort competition affect just a minor share of total bilateral commerce. However, a number of developments have been accumulating in recent years between' the two giants of international trade that involve heightened bilateral bickering and, what is more important, pose a threat to the functioning of the multilateral trading system for which the EU-US "connection" has always been pivotal. Multilateral liberalisation and rule-making under the old GATT (1947), from the Geneva Round (1947) to the Uruguay Round (1986-93), were regularly instigated by the USA and largely driven by American concerns about discriminatory and distortionary aspects of European integration (including features of "deep integration" such as the common agricultural policy/CAP) at its various stages. Then, in the run-up to the first round of multilateral trade negotiations under the newly created WTO,[3] launched at Doha (Qatar) in November 2001, the EU for its part became the driving force of the multilateral process. It drew a reluctant USA, narrowly focussed on market-access issues, into a broad negotiation agenda (Doha Development Agenda) that comes near to the comprehensive Millennium Round programme pushed for in the late 1990s by Leon Brittan, who was EU trade commissioner at the time.

Figure 1
Interregional Trade Flows, 2000[a]

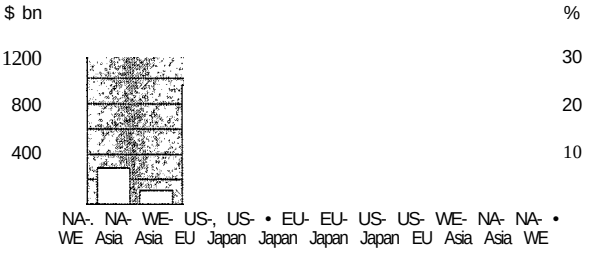


[a] In billion dollars (left-hand scale) and per cent of world trade (rigth-hand scale).

Note:. NA = US, Canada, Mexico; Asia excl. Mid East and Australia/New Zealand.

Source: WTO.

Figure 2
Interregional Foreign Direct Investment, 1998[a]



[a] In billion dollars (left-hand scale) and per cent of world FDI stock (rigth-hand scale).

Sources: EUROSTAT; OECD; UNCTAD.

Growing Disagreement

However, since the EU-US closing of ranks in Doha, inadvertently helped by the events of September 11, 2001, in New York, growing mutual disrespect and disagreement in the field of foreign and security policy (such as strong differences in views on the Arab-Israeli conflict, on Iraq and even on the next steps in the campaign against terrorism) have apparently

[1] Cf. G. Barba Navaretti, J. I. Haaland, A. Venables: Multinational Corporations and Global Production Networks: The Implications for Trade Policy, Centre for Economic Policy Research, London 2002.

[2] Cf. Q. Wang: Import-Reducing Effect of Trade Barriers: A Cross-country Investigation, IMF Working Paper, Washington, DC, December 2001.

[3] Encompassing the new GATT (1994) together with far-ranging agreements on services (GATS) and trade-related aspects of intellectual property (TRIPs).

"spilled over" into the economic area while longer-standing economic conflicts of interest *sui generis* have come to the fore again. Arguably, widening differences and a stronger domestic-policy calculus are characteristic of current EU-US relations in general and trade relations in particular, replacing the "natural" close transatlantic ties observed in the era of the east-west conflict. To some extent, though, a calmer reality of quiet cooperation on common interests may lie behind the public noise currently generated by opposition politicians and newspaper columns.

EU-US commercial conflicts take pride of place in WTO dispute settlement activities.- Of current proceedings, more than a dozen deal with controversies in which the EU and the USA are jointly involved either as the complaining or defending party. Most prominent are various steel cases (among which the request by the EU and other trading partners for an investigation panel on the high (up to 30% *ad valorem)* extra tariffs of March 2002 on large parts of US steel imports stands out), the case on US tax incentives for exporters (via Foreign Sales Corporations/FSC or Extraterritorial Income Exclusions/EIE) and the "hormones" case against the EU ban on imports of beef produced with growth promoting hormones. Future cases may include an EU et al. challenge of the new US farm bill, just signed into law by President Bush, that provides for massive increases in subsidies to US farmers. The broad range of contentious issues among the EU and the USA affects traditional and modern areas of the economy and covers "classical" trade policy conflicts, where "border measures" (such as tariffs) protect domestic industries against foreign competitors, as well as "systemic" conflicts which have their roots mainly in different regulatory systems "behind the border". In these areas, multilateral rules often do not yet exist, for instance in the field of competition policy or audio-visual services.

The USA is the world's leading user of old-style safeguard or escape clause measures, which reached a climax with the steel tariffs noted above. This kind of protectionism has experienced a full-blown revival in recent years as worldwide safeguard cases more than doubled, from 26 in 2000 to 53 in 2001. The EU did not jump onto the bandwagon until April 2002, when it installed safeguards of its own (in the form of quotas and tariffs) against steel imports in order to shield domestic producers against possible trade diversion caused by the widespread closure of the US steel market.

Safeguard measures which are typically applied *erga omnes,* i.e. non-discriminating among trading partners, had for some time given way to selective antidumping measures against specific countries and companies. The antidumping instrument has also frequently been used to substitute for grey-area measures like voluntary export restraints (VERs), which have largely disappeared following their prohibition in the Uruguay Round's Safeguards Agreement. Recently, antidumping investigations have expanded further, the resurgence of safeguard actions notwithstanding. In this field, too, the USA is leading the way. In 2001, it initiated a record number of almost 80 antidumping investigations, out of a world total of nearly 350 cases in the same year, which is also the highest number recorded to date. The EU was a less active player than the USA in the antidumping field in 2001 (with 27 investigations initiated), just as in 2000, but in 1999 it had been the most frequent user here (with 66 cases as against 46 cases for the USA).[4] With the Byrd Amendment (signed into law in October 2000 and contested thereupon in the WTO by the EU and eight other WTO members), which earmarks the proceeds from antidumping measures to the US companies responsible for bringing the cases, the USA has added a further twist to antidumping policies by "cumulating" import protection with subsidisation.

This can be likened to the current debate in the EU about a possible ^introduction of state aid to European shipyards (expired in January 2001) as a back-up to a WTO challenge to be brought by the EU against South Korea because of alleged unfair competition in shipbuilding. The issue has, more generally, exposed divisions within the European Commission between advocates (like Pascal Lamy, the trade commissioner, and Erkki Liikanen, the enterprise and industry commissioner) and opponents (like Mario Monti, the competition commissioner) of subsidies for ailing industries in the EU. At the same time, the altogether tough stance taken by the Commission in the field of subsidies control in past years has come under fire from those EU member states where most of the aids are devised and effected. Log-rolling among EU members - for instance, trading German coal subsidies against special tax breaks for road haulage industries in France, Italy and the Netherlands - and resulting "package deals" threaten to undermine existing disciplines. In addition to this, and more relevant to EU-US

[4] Cf. Global Protection Report 2002, . available from: cstevenson@eu.mayerbrownrowe.com.

relations, government spending is most generous in European high-technology industries. A recent example is Galileo, the European satellite navigation project agreed at the European summit in Barcelona in March 2001, that is being pitted against the rival US-developed Global Positioning System in a similar way as Airbus Industrie was set against Boeing in the late 1960s. It is a case of strategic industrial and technology policy with a poor economic rationale underlying the programme. Similar tendencies hold in the United States. Taken together, industrial and R&D subsidies granted on both sides entail considerable potential for mutual friction.

Agriculture: Change of Roles

In the field of agriculture, a remarkable exchange of roles has taken place with the enactment of the new US farm bill, which is in stark contrast to the American insistence in Doha on putting freer trade in agriculture at the heart of the new trade round. It is no small irony that Franz Fischler, the EU commissioner for agriculture, accuses the USA of "flunking" farm reform and now doing exactly the opposite of what it liked to preach to others and particularly so to the EU. The legislation allows an increase (by about 80% over ten years) of subsidies to a host of farm products, including the USA's biggest crops (soyabeans, corn and wheat), largely related to prices and production and hence prone to seriously distort international trade. It is an about-turn from the previous Freedom to Farm Act of 1996, with its declared intention of phasing out agricultural subsidies, and it provides the EU with an excuse to put off changes to its own agricultural policy, which since the McSharry reforms of 1992 has been moving away from price and production based subsidies towards direct payments to farmers with a much smaller impact on trade. At the multilateral level, such protectionist farm support policies are, of course, the wrong signal as they frustrate hopes of improved market access, in particular for developing countries, and reduce incentives to open up (not only agricultural) domestic markets.

With regard to "systemic" conflicts, the FSC/EIE dispute is a case in point. At stake is the US system of universal taxation (as against the European territorial system) which in a WTO dispute settlement procedure (invoked by the EU) was found to be at odds with multilateral trading rules in that it permitted US-based companies to exempt export earnings from income taxes, and thus entailed export subsidies prohibited in the WTO (particularly under its subsidies agreement). The USA would consequently have to revise its corporate tax laws, which is however unlikely to happen any time soon, despite the good intentions expressed by the White House at the latest EU-US summit in May 2002 in Washington, as the US Congress shows little willingness to accept that the WTO has any role to play in domestic tax policy. As a result, the EU may go ahead with the trade sanctions against the USA to which it has been entitled by the WTO dispute settlement body. The potential amount of these measures is a multiple of the value of any sanctions approved in the WTO to date, such as e.g. the trade restrictions imposed by the USA against the EU in the "hormones" conflict.[5]

Widely Differing Approaches to Regulation

The common denominator of the FSC/EIE and "hormones" cases is widely differing approaches to economic regulation between the EU and the USA, concerning both its intensity and content, with big potential for commercial friction. The same is true in the field of biotechnolgy, where the EU insists on the "precautionary principle" (e.g. with regard to "genetically modified organisms") which is sharply rejected by the USA and in the area of competition policy where "Microsoft" is the latest bone of contention after "Boeing-McDonnell Douglas" in 1997 and "General Electric-Honeywell" in 2001 had already brought the EU and the USA near to the brink of a trade war. In this field, a pioneering bilateral cooperation agreement (introducing, for instance, the principle of "positive comity" into competition policy[6]) has not prevented fundamental disagreements from arising between the two, particularly in the assessment of mergers and abuse of market dominance. The idea of mutual recognition, as a "bridging" device between different regulatory systems, which was successfully pushed by the Transatlantic Business Dialogue (TABD)[7] in the field of

[5] The allowed FSC/EIE retaliation (to be determined by a WTO arbitration panel by mid-June 2002) will lie between $ 1 billion (i.e. the equivalent to the value of sales lost by EU companies to US companies as a direct result of the tax break) and $ 4 billion (i.e. the equivalent to the value of the subsidy) compared to less than $ 200 million in the "hormones" case.

[6] This basically means that the foreign country would, on behalf of the home country and according to its own rules, prosecute anticompetitive behaviour that originates within its territory but mainly affects competition in the other country.

conformity assessment procedures, has apparently not made much headway elsewhere.

Transatlantic convergence in trade policy tends to occur in a more problematical sense as US trade policy increasingly incorporates similar discriminatory elements as have been characteristic of EU trade policy, with its elaborate hierarchy of trade treaties, from the outset. The USA, too, is intensely seeking bilateral free trade agreements with foreign countries and at the same time designing in a discriminatory way trade measures that are in principle jion-discriminatory. For instance, the USA's NAFTA partners have been exempted from the *erga omnes* steel tariffs, as a reward for concluding bilateral deals with the USA, while the multitude of company and product specific exemptions in this case are with good reason interpreted to demonstrate a "willingness (of the Bush administration) to sacrifice non-discrimination to political expediency".[8]

The high political content of trade policy, which in the EU largely derives from trade policy's being used as a substitute for foreign policy, is in the USA mainly determined by domestic policy considerations that seem to override aspects of international cooperation. Just as the steel tariffs were imposed to win votes in politically tight "rust belt" states, farm subsidies are being increased with votes in "swing" states of the "prairie belt" in mind. Robert Zoellick, the US Trade Representative, also says that "a little protectionism", such as in steel or agriculture, will produce enough political support for a lot more free trade for everyone via the Fast Track or Trade Promotion Authority that is requested by President Bush from the US Congress to enable him to credibly negotiate trade accords with other countries without the risk of subsequent amendments in Congress which would just have a yes-or-no option. However, in view of a strong tendency in the US Congress to be more worried about the losses than the potential gains from further trade agreements, that proposition may actually backfire.

To conclude, a stronger political mobilisation of pro-trade forces is needed. One could also think of inserting a private right of complaint against violations of trading rules by governments into the multilateral order. Moreover, the dispute settlement mechanism of the WTO deserves further development. In this context, it is worth reconsidering the concepts of retaliation and compensation in trade conflicts with regard to both the methods applied (e.g. replacing retaliatory tariff increases or compensatory tariff cuts by direct transfers from the defending to the complaining country) and the magnitudes involved (e.g. limiting sanctions to the trade gains foregone which in most cases are just a fraction of the trade volumes affected). The "clash of the titans" EU and USA must be contained for the sake of the overall trading system.

[7] TABD is one of many transatlantic fora created by no less numerous transatlantic initiatives, culminating in the failed NTMA (New Transatlantic Marketplace Agreement) of 1998, which was followed by the much vaguer TEP (Tranatlantic Economic Partnership) project that has not produced any concrete results to date.

[a] Cf. J. Bhagwati, A. Helton: Bush trades his principles, in: Financial Times 18.4.2002.

Claude Barfielcf

WTO Dispute Settlement System in Need of Change

Ironically, the United States and the European Union are victims of too much substantive success in multilateral trade negotiations, combined with overreaching in the area of dispute resolution. As unlikely as that proposition sounds, it is a highly plausible explanation of the most important conflicts that have beset trade relations between the two trade superpowers since the creation of the World Trade Organization in 1995. To understand how this occurred, a brief history of the GATT/WTO system is in order.

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"Diplomatic" vs. "Legalistic" Approach

Throughout the history of the postwar multilateral trading system, presided over first by the General Agreement on Tariffs and Trade and since 1995 by the new WTO, two distinct theories regarding the settlement of trade disputes have competed for dominance. On one side are the "pragmatists" who argue for a "diplomatic" approach that stresses conciliation and problem-solving over legal precision. This view of dispute resolution was generally espoused by Europeans; and as late as the 1980s, a Swiss GATT Director General stated: "GATT cannot be a world trade court. Conciliation is our priority: it is not our job to determine who is right and wrong." On the other side were the "legalists" or "rules-oriented" proponents who hold that legally binding rules will produce more certainty, predictability and fairness for all GATT/WTO member states. US trade policymakers and scholars, particularly, have championed this approach.

Though the system today retains some blend of the diplomatic and legalistic philosophies, decisions taken during the Uruguay Round (1986-1994) marked a clear shift toward a more judicialized, legally binding dispute settlement system. The most far-reaching change on the dispute settlement process was the introduction of "automaticity," whereby decisions by WTO panels or the Appellate Body will stand unless there is a consensus (virtual, unanimity) among WTO members *against* the panel or Appellate Body decision. Given the extreme difficulty of amending or interpreting WTO rules (requirement of consensus or three-fourths majority), de facto the new system gives final say to these judicial bodies.

Given the imbalance between the very efficient, binding judicial system and the inefficient, cumbersome rulemaking apparatus, there is the danger - already identified by a number of WTO scholars - that WTO member states will increasingly look to the judicial system to "create" new law or amend existing laws. As Marco Bronckers, a leading European legal scholar has written: "Governments may too easily think that progress can be made in the WTO through enforcement; that litigation is a more convenient way to resolve difficult issues than an open exchange at the negotiating table. That is troubling because it undermines democratic control over international cooperation and rule-making ..."

Further, the mindset of the new legal culture is at odds with diplomatic accommodation. Professor J.H.H. Weiler, a strong advocate of the new system, has candidly admitted that though the rule of law is supposed to be dispassionate and objective, when two parties both believe that the law is on their side and litigate, "then it becomes a profession of passion, of rhetoric, of a desire to win...all inimical to compromise." Likewise, though legal professionals should act objectively on the merits of a case, in reality they are (like other professionals) "people with ambition, with a search for job satisfaction." Thus, according to Weiler: " 'We can win in court' becomes in the hands of all too many lawyers an almost automatic trigger to 'we should bring the case.'" The bottom line regarding the old system of consultation and conciliation, as one US trade lawyer has pointed out, is that it "has disappeared as a meaningful step in the process. To consult openly is to risk your country's case as an advocate, as any admission is going to be used against you. Only consult seriously if you wish to confess judgment and make amends - that is the lesson of the DSU."

The triumph of binding legalism came just at the time when the results of the Uruguay Round had vastly expanded the substantive reach of the international trade regime. New rules in the area of health and safety, and for the services industries - banks, insurance companies, telecommunications and the Internet, energy services and transportation, for example - meant that the multilateral trading system would be asked to deal with complex issues that go deep into the economic and social structures of its member states. In addition, a wholly new regime for intellectual property was established, at a time of great ferment within individual nations over challenges to intellectual property emerging from new technologies such as software and biotechnology. Sylvia Ostry, a former Canadian trade negotiator now at the University of Toronto, has described the resulting new model: "The degree of obtrusiveness into domestic sovereignty bears little resemblance to the shallow integration of the GATT with its focus on border issues ... The WTO has shifted from the GATT model of *negative* regulation - what governments must not do - to *positive* regulation, or what governments must do."

Unsustainable Dispute Settlement System

As the two leading superpowers of trade, the United States and Europe constitute the indispensable central core of the multilateral trading system. And the seeming intractability of an

increasing number of disputes between the two WTO leaders is a harbinger of greater systemic problems. Specifically, in a recent book, I have argued that the new WTO dispute settlement system is unsustainable, both politically and substantively.[1] It is not sustainable politically because the constitutional flaw stemming from the imbalance between the powerful judicial system and the weak and ineffective rulemaking procedures will, over time, create major questions of democratic legitimacy. In retrospect, it was relatively easy to rebut charges of democratic illegitimacy against the delegates to Seattle in 1999: they were appointed officials of (mostly) democratic governments. It will be another thing, however, to defend the actions of WTO judicial bodies when it is alleged that they are "legislating" new rights and obligations through judicial interpretation.

Substantively, there are two problems. First, even with the best of wills, panels and the Appellate Body face a daunting task in interpreting the underlying text and rules because, as even defenders of the new system admit, they contain numerous gaps and ambiguities, lacunae, and contradictory language that papers over basic policy differences among negotiators. More fundamentally, there is no consensus in a number of instances on the complex regulatory issues posed in such areas as services regulation, health and food safety, and national intellectual property regimes.

The Beef Hormones Case

For the purposes of this essay, two major WTO judicial confrontations between the US and the EU illustrate the political and the substantive conundrums engendered by the new system. The first is the well-known Beef Hormones Case, which remains a standoff with Europe continuing to pay over $100 million in compensation for refusing to abide by a WTO ruling. There could be no better example of the folly of a promise of a legally "correct" decision in a program area than this case. Underlying the complicated facts of the dispute is a fundamental disagreement about how societies should handle risk. The EU is moving inexorably toward an expansive interpretation of the "cautionary principle," whereby nations can ban the import of goods with minimal (or no) scientific evidence. The US (and some other nations) are moving in the other direction - toward mandating credible scientific data before allowing trade restrictions. WTO rules seem to point to at least minimal scientific justification, and assume that invocation of the "precautionary principle" will be temporary, pending additional data.

When confronted with such dissonances, the Appellate Body produced a decision laced with a hodgepodge of creative, yet unintegrated rationales. It upheld the need for scientific evidence, while undercutting that mandate by allowing socioeconomic arguments (including public opinion) to rank with science in determining import policy. It denied the EU's contention that the "precautionary principle" had reached the status of customary international law at this time - a truly radical assertion - but held out the possibility that in the future the situation might change. (Subsequently, the EU compounded the problem by flouting the clear statement in WTO rules that the "precautionary principle" can only be utilized "provisionally" and temporarily; in effect, it defended an invocation virtually in perpetuity.) Whatever the specific outcome in each of these questions, the debate centered on issues that potentially altered the rights and obligations of WTO members - and thus should not have been confined to the single discretion of WTO judicial bodies.

The FSC Cases

The equally famous FSC cases concerning alleged WTO-illegal tax subsidies for US exporters is another illustration of both the incapacity of the Dispute Settlement Understanding to deal with a complex international economic issue (international taxation) and the dangerous consequences of pronouncing on highly charged political issues. (It should be noted that the author is a strong opponent of *any* subsidies for exporters and would abolish as corporate welfare such US programs as those administered by the US Export-Import Bank and OPIC. The issue here, however, relates to WTO rules and adjudication - and not the wrongheadedness of export subsidies.)

Fundamentally, the issues in these cases stem from differing national approaches in taxing foreign source income of corporations. The United States generally uses a so-called worldwide system of taxation - that is, it taxes income of a person or corporation regardless of where the income is earned. European nations in general utilize the so-called territorial system under which countries tax all income within their border but do not tax income earned abroad.

[1] Claude Barfield: Free Trade, Sovereignty, Democracy: The Future of the World Trade Organization, Washington, DC 2001, AEI Press.

Conflicts have arisen for three decades as the United States has attempted to level the playing-field and replicate some part of the European foreign source income exemption. Suits and countersuits were launched in the 1970s under the old GATT. A standoff ensued when *both* the European (at least for several countries) and the US international tax system were found in violation of existing trade rules. In 1981, a political "Understanding," ratified by the GATT General Council, was reached that agreed that with respect to these cases *"and in general,"* economic processes, including transaction involving exported goods, need not be taxed by the exporting country. Fifteen years later, in a fit of pique and after much negotiating water had flowed over the dam, the EU challenged the then existing US export credit regime.

Brushing past ample *legal* authority to uphold the validity of the 1981 Agreement, a WTO panel and the Appellate Body upheld the EU challenge. The US Congress then revised the export tax regime, only to have a panel and the Appellate Body once again find for the Europeans. In this last case, the Appellate Body put forward a standard that assumed the possibility of a "bright line" between foreign and domestic income — and struck down the US law for establishing formulas that partially mixed the two. As the US trade and tax expert, Gary Hufbauer, has stated, this interpretation could only have been advanced by a "first-year law student... with only limited knowledge of tax law."

To conclude this section, these cases (and others that could be cited) illustrate the twin dangers inherent in the mindset of the panels and the Appellate Body - that is, incautious incursions into highly volatile political areas such as food safety and international taxation, combined with a determination to provide a legally "correct" answer to all questions, even when it means - as with the FSC decisions - that they will be forced to venture into complex substantive areas beyond their competence.

What is to be Done?

The aim of the following recommendations for change in the WTO's dispute settlement system is: (1) to reintroduce some elements of the older GATT diplomatic approach, with an emphasis on mediation and conciliation rather than legal fiats; and (2) to rein in the judicial bodies and thereby lessen both sovereignty and legitimacy concerns. The recommendations are complementary but independent - that is, the WTO could adopt them singly or in some combination.

1. *A Safety Valve: Mediation, Conciliation and Arbitration:* Under this proposal, the WTO Director General or, alternatively[1]-^ Committee of the WTO Dispute Settlement Body, would be empowered to step in and direct the contending WTO members to settle their differences through bilateral negotiations, mediation or arbitration by an outside party. Such action would be taken in situations where, in the judgment of the Director General or the Committee, the highly divisive political nature of the contest would permanently damage the WTO, or where clearly the underlying text masked deep substantive divisions between WTO members.

2. *A Blocking Mechanism:* The goal of this proposal is to redress the current imbalance between the highly efficient dispute settlement system and the inefficient, ineffective consensus-plagued rulemaking process. At any time, at least one third of the members of the WTO Dispute Settlement Body, constituting at least one quarter of trade among WTO members, disagreed with a judicial decision, that decision would be set aside until the issue could be negotiated out in the WTO General Council, or as part of an overall round of trade negotiations.

In addition, two less radical changes should be considered. They would constitute new guidelines for future panels and the Appellate Body.

1. *Non liquet Doctrine:* This legal term literally means "it is not clear." Given the widespread agreement that WTO texts are replete with lacunae and contradictory provisions, *and* given that questions concerning the legitimacy of judicial decisions are magnified at the international level, the panels and the Appellate Body should be instructed to utilize this doctrine much more frequently - and throw the decision back to the WTO General Council or to trade round negotiations. Critics of *non liquet* have argued that it is prohibited because international law is necessarily "complete," or that it is the duty of judges to step in and fill gaps, particularly in contentious areas. WTO rules, by common consent, are certainly not "complete" and arguments for "gap-filling" by judges reflect a dangerous - even anti-democratic - myopia.

2. *Political Question Doctrine:* Alternatively, the WTO could adopt a variation of the so-called "political issue doctrine," developed by the US Supreme Court. The doctrine is meant to provide a means for the judiciary to avoid decisions that have deeply divisive

political ramifications and thus, in the opinion of the court, should be settled through more traditional democratic processes, involving both the legislature and the executive. Once again, if such a doctrine is deemed important for preserving checks and balances at the national level, an even more cogent argument can be advanced for its introduction in international law - where the sources of legitimacy of judicial bodies are much weaker than within democratically constructed nation^states.

In summary, the proposition advanced here is that heading off corrosive conflicts between the US and the EU in the future will necessitate reform of the international trading rules that have enmeshed - and indeed entrapped - both trading superpowers.

Wolfgang Ischinger*

We Have Little to Gain from Trade Disputes, but Very Much to Lose

September 11 changed the transatlantic relationship suddenly and profoundly. There have not been many moments in the last 50 years when Europeans have felt as close to America as in the immediate aftermath of September 11 - both politically and emotionally. Germany has been one of the closest US allies in the fight against terrorism and has been a driving force in the effort to mobilize international support for the far-reaching and ambitious US campaign. The gathering of 200,000 Germans at the Brandenburg Gate was an impressive display of solidarity, and no one showed greater generosity in assisting the victims than did the Germans.

We as Germans regarded September 11 as an attack not only on the US but also on ourselves, on our common values. It is this commitment to our shared values that distinguishes the transatlantic relationship from any other interregional cooperation in the world. September 11 created a new sense of common purpose. Combating international terrorism moved to the top of the agenda. Germany has made clear that it stands by the US, and we have lived up to that commitment. For the first time since World War II, Germany has committed troops to a military operation outside of Europe. One might say that September 11 accelerated German policy-making. It offered a shortcut to a country which, just a few years ago, thought it had no business sending its armed forces abroad. Today, we are bearing a fair share of the burden involved in overcoming international terrorism.

September 11 also demonstrates that transatlantic relations have undergone a major transformation over the last 50 years. During the Cold War era, transatlantic relations were shaped by the security situation in Europe and by economic competition. With the end of the Cold War and the collapse of the bipolar order, the US has emerged as the dominant military power. At the same time, the post-Cold War era has seen the rise of serious trade disputes between the transatlantic partners. September 11 signals the beginning of a new "post-post Cold War era," for it has revealed that security threats are generally now more complex and call for concerted efforts. Common threats call for common answers of the transatlantic partners, both in the political and economic sphere.

Does this mean that we are heading toward a new golden age in transatlantic relations? Probably not. There are too many unresolved issues to deal with; just to mention a few: Kyoto, arms control, growing disputes over agriculture, aircraft, beef, dispute settlement modalities, genetically modified products, mergers a la GE-Honeywell, regional . preferential deals, retaliatory methods, sanctions, steel, subsidies,

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tax policy, and so on. Trade-related matters represent only one element of the transatlantic agenda, but many of these issues have broader foreign policy ramifications. Against the backdrop of our demonstrated solidarity with the United States in the war on terrorism, increasingly critical questions are being raised: what are we getting in return for being good allies of the US?

Transatlantic Trade Disputes: The Steel Example

The European Union has shown itself disappointed about President Bush's March 5 decision to impose protective tariffs of 30 percent on most steel imports to the US. The US steel decision is based on an investigation conducted by the US International Trade Commission (ITC) which the Bush Administration launched last summer under Section 201 of the US Trade Law of 1974. It is estimated that these measures will affect well over half of all US steel imports. They reached a peak of almost 39 million metric tons in 1998 and fell to about 28 million metric tons in 2001. Approximately 5.5 million metric tons originated in the EU, of which almost 1.6 million metric tons came from Germany. Of this, about 1.2 million metric tons'would be affected by these US measures.

If one compares, however, the ratio of transatlantic trade in steel to EU-US trade as a whole, it is hard to understand why there is so. much emotion and passion in the steel debate on both sides of the Atlantic. Overall trade between the European Union and the US has never been more intense. The US is the most important trading partner of the EU. In 2000, the US imported goods worth $220 billion from the EU and the EU imported goods totaling about $165 billion from the US. Thus, 20 percent of US and EU trade is within the transatlantic region. The German economy in particular is closely intertwined with the US. Germany exports about $60 billion worth of goods to the United States each year, with cars accounting for 40 percent of the total. By contrast, German steel exports to the United States, at about €750 million, are relatively small in comparison; steel accounts for only 1 percent of Germany's total exports to the US. Thus, based on this overall picture, the heated debate over steel looks rather marginal.

Nevertheless, the closure of the American market could lead to serious distortions in world steel trade. From an economic perspective, consumers and producers in steel-consumption industries will pay a heavy price for steel protection. Protectionism distorts market signals that might otherwise encourage investment in new industries and discourages workers from seeking the opportunities such new investments would provide. In addition, renewed economic growth might push US steel imports higher in 2002, despite new tariffs of up to 30 percent. Thus, the US duties could have a negative impact on domestic steel-consuming companies because of rising prices and specific product shortages.

Although domestic steel producers blame imports for more than 30 bankruptcies since 1997, the real cause of the US steel crisis was a price war among steel mills as the US economy slowed in late 2000 and 2001. In addition, the US steel industry faces financial difficulties because of "legacy costs," that is, health care and benefits owed to retired steel workers. These expenses are costing the industry about $13 billion. Over the past three decades, US steel producers have been shielded from foreign competition by quotas, voluntary, export restraints, minimum price undertakings, and hundreds of antidumping, countervailing duties, and safeguards measures. Employment in the steel sector has declined by more than 60 percent since 1980 largely because productivity growth - driven primarily by the success of America's mini-mill producers - has outpaced demand.

But the US steel decision is not all about economics, it is also about politics. The steel industry is, of course, a very sensitive issue on both sides of the Atlantic. In Germany, after a period of serious and painful reforms, the steel industry is now highly modernized and is capable of facing international competition. Second, because of the exceptions made for Mexico and Canada, US NAFTA partners, and for developing countries, the major burden of the US duties will mainly fall oh imports from the European Union. Third, the US decision on steel is related to the politically sensitive states which the Republicans hope to win in November. This is another reason emotions are running so high: Europeans feel that the US puts a higher value on domestic political objectives than on international trade commitments and the transatlantic partnership. Doubts in Europe about the US commitment to free trade are growing, also with regard to the new round of WTO negotiations agreed upon in Doha last year.

The Strategic Dimension of Transatlantic Trade: "Tit-For-Tat"

During the Cold War, there was no shortage of trade disputes between the European Union and the US. But both sides always showed a degree of restraint,

even if some "tit-for-tat" retaliation took place. Both sides were aware of the risk that economic conflict could spill over into the political arena. When the Cold War ended, new ways needed to be found to prevent strains in the economic relationship that could jeopardize political partnership. That is why the European Union worked so closely with the US to resolve these conflicts in a multilateral framework and initiated the Doha trade round.

The EU has now taken the steel issue before a panel of the WTO, estimating the damage from the tariffs at about €2 billion. The European Commission is quite confident that the WTO will concur with the EU, because US steel imports have fallen in recent years and not risen, as the WTO requires for the imposition of protective measures. At the same time, Europe faces pressure to act quickly to protect its own steel market from a further rise in imports from countries that are now blocked by the US. The EU introduced, according to WTO rules, preliminary safeguard measures against such imports on March 29. Brussels intends in a second step sanctions against the US (author of the first protection step) by mid-June this year, provided they are approved by a majority of the member states.

The tight US steel market will make it attractive for the Bush Administration to respond positively to a long list of US steel consumer requests for specific products to be exempted from the tariffs. Even US steel processors are, to a large extent, dependent on specific imports, including imports from Germany. Thus, German companies are hopeful that the US will exempt their products from the protective tariffs in the coming weeks. Negotiations on product exclusions will.not be conducted directly between the US and the European Commission or EU member states. Rather, the United States will deal directly with individual companies.

The risk remains that "tit-for-tat" behavior will spiral out of control and might turn a "rather marginal" trade dispute into a more serious "trade war." As German Economic Minister Werner Miiller recently pointed out, such a development would have serious consequences for Europe and, especially, for the German economy. A conflict over protectionist tariffs would also be harmful to the ongoing economic recovery process under way on both sides of the Atlantic. That is why Germany is advocating a negotiated settlement, not an escalation of the steel dispute.

Transatlantic Relations for the 21st Century

Europe remains the indispensable partner of the United States. Europe and the US are the world economy's engine of growth. Together, we have built a multilateral trade system, which we need to maintain and improve. As NATO allies, we have worked together to preserve peace and project stability in Europe and beyond. Together, we are pursuing the strategic aim of a just and stable peace order for Europe that includes Russia. Now the time has come to make the transatlantic relationship fit for the global agenda of the 21st century.

Fred Bergsten of the Institute for International Economics in Washington recently pointed out that the United States and Europe are the world's only economic superpowers. The two countries are crucial both to each other's prosperity and to the stability of the world economy as a whole: "Both [The United States and Europe] need instead to start thinking in terms of cooperating and indeed coordinating consistently, both to minimize the problems they cause each other and to provide progressive leadership for the world .... rather than antagonists over bananas, steel, and other minutiae."[1] Bergsten's idea points to a very basic need. If we are going to cooperate in seeking to promote global peace and stability, we need to understand each other's political processes and avoid potentially poisoning trade disputes. Trade is a perfect example where multilateral cooperation and coordinated policies are in everyone's interest. The United States does not dominate the world economy as it does in global security affairs, and Europe is its only reliable partner in the search for global economic growth and stability. What we should strive for, therefore, is a US-European pact, to stand side by side, and not opposed to one another, on trade issues. This effort, obviously, should balance all involved interests and should not be at the expense of third parties. We have little to gain from trade disputes, but very much to lose.

Joseph Nye of Harvard recently said, "Although the United States does well on the traditional measures, there is increasingly more going on in the world that those measures fail to capture. We must mobilize international coalitions to address shared threats and challenges. America needs the help and respect of other nations. We will be in trouble if our unilateralism prevents us from getting it."

I could not agree more.

[1] Fred C. Bergsten: The Transatlantic Century, in: Washington Post, April 25, 2002.