Trade and Investment: An American Perspective

Gary Hufbauer and Frederic Neumann
Institute for International Economics, Washington DC

Conference Draft – Subject to Change
Introduction

In matters of trade and investment, as the conference theme suggests, conflict, cooperation and convergence have all characterized relations between the United States and Europe. The seminal conflict event was Europe's decision to cement its original Common Market with the Common Agricultural Policy. The seminal cooperation event was the Cold War alliance, which submerged commercial disputes for forty years. No seminal event launched convergence; rather, convergence has been the outcome of increasingly deep trade, investment and financial ties across the Atlantic. Liberalization under the auspices of the GATT/WTO and the OECD promoted convergence over the past half century, but the force of markets, culture and language were far more important than policies emanating from Washington, Brussels, or other European capitals. If policy had been the driver of convergence, long ago Europe and the United States would have created the first NAFTA -- the North Atlantic Free Trade Area.

In this paper, we focus on events since 1990. By describing and classifying recent episodes of conflict and cooperation, we attempt to lay a foundation for projecting US/EU commercial relations over the next decade. Before delving into past episodes and future projections, however, we provide an overview of US/EU commercial relations between 1990 and 2000.
Overview of Commercial Relations

Table 1 gives familiar statistics for US/EU merchandise trade and services trade, related to total trade magnitudes and GDP, for the decade 1990 to 2000. Table 2 performs the same exercise for foreign direct investment (FDI). In absolute terms, of course, the numbers are huge -- as befits commercial relations between the world's two dominant "countries" (characterizing the EU as a single country, though it is more accurately an economic federation). Two-way trade (merchandise and services) totaled $557 billion in 2000; two-way FDI stock totaled $1,376 billion. More interesting than absolute numbers, however, are three sets of comparisons.

US/EU Commerce Relative to Global Magnitudes

The first set of comparisons involves US/EU trade and investment relative to global magnitudes over the decade 1990 to 2000. These come straight from tables 1 and 2. Relative to global magnitudes, the overarching feature of US/EU trade relations is stability. Relative to total U.S. imports, U.S. imports from the European Union amounted to 22 percent of the total in 1990, 21 percent in 1995, and 21 percent in 2000. Not much change there. Conversely, relative to total EU imports from non-EU countries (i.e., extra-EU imports), EU imports from the United States amounted to 16 percent of the total in 1990, 18 percent in 1995, and 17 percent in 2000. Other comparisons, for example separating merchandise from services, or comparing trans-Atlantic trade to world trade, show more movement over the decade. But mature stability rather than dynamic change is the dominant flavor of US/EU trade volumes.
The story for foreign direct investment is similar. Relative to total FDI placed in the United States, the FDI stock controlled by EU firms amounted to 58 percent of the total in 1990, 56 percent in 1995, and 65 percent in 2000. Conversely, relative to total FDI placed in the European Union (including intra-EU foreign direct investment), FDI stock controlled by U.S. firms amounted to 25 percent of the total in 1990, 27 percent in 1995, and 24 percent in 2000. However, trans-Atlantic FDI actually declined relative to world FDI dropping from 26 percent of the world total in 1990 to 22 percent in 2000. Again the investment picture is the mature closeness of an older couple.

As might be expected both trade and investment magnitudes are growing relative to GDP levels in the United States and the European Union. This growth, shown in the foot of tables 1 and 2, is sharper for investment than trade. Trade and investment expansion relative to GDP are part of the globalization that has characterized the world economy since the Second World War. What’s more interesting is that US/EU commerce, by and large, is rising at about the same speed as the global tide of economic integration.

**US/EU Conflicts Relative to Commerce**

The second set of comparisons relates the size of trade and investment conflicts relative to the volume of trade and investment in 2000. Table 3 provides rough figures for evaluating the size of conflicts. Based on estimates reported elsewhere, we have roughly “sized up” trade and investment disputes over the decade 1990-2000. In scaling the disputes, we have deliberately erred on the high side. At the foot of the table, we
aggregate the estimates, even though the aggregation has an "apples and oranges" quality: some disputes were resolved after a few years (e.g., the dispute over European exports of textiles to the United States), while others dragged on for years (e.g., Hush Kits and Beef Hormones).

The important point that comes out of this table is that conflicts are small relative to base volumes of overall trade. Related to total US exports to Europe in 2000, US complaints about European merchandise barriers over the decade concerned less than 5.4 percent of trade. Conversely, related to total European exports to the United States in 2000, European complaints involved less than 5.1 percent of trade.

Such comparisons do not mean that the conflicts are unimportant to the parties involved, nor do such comparisons diminish the precedents established by certain contests. However, the figures do suggest that, even if all conflicts were settled in favor of the complaining party, increments to the flow of trans-Atlantic trade, or the stock of trans-Atlantic investment, would be modest. By extension, from this body of data, one might conclude that trade and investment frictions perturb only modest quantities of commerce, and that faster dispute resolution and more expeditious negotiations can, at best, only marginally improve the already robust commercial relations between the United States and Europe.

Keeping those preliminary conclusions in mind, we turn to the third and final set of comparisons.
US/EU Actual vs. Potential Commerce

Table 4 provides conjectures as to the potential scope of US/EU commercial relations. The conjectures are drawn from two sources. The first source is the set of CGE estimates developed by Brown, Deardorff and Stern (2001). In their work, Brown and her colleagues estimated (among other calculations) trade creation and welfare gains if post-Uruguay Round barriers are completely removed, either regionally or multilaterally. Their model incorporates dynamic features, which possibly result in “high end” estimates of welfare gains. The second source is the set of CGE estimates made by Scollay and Gilbert (2001). Scollay and Gilbert also calculate trade creation and welfare gains from multilateral and regional free trade. Their model sticks to a textbook static framework, which possibly results in “low end” estimates of welfare gains. While their calculations of potential welfare gains differ, the two CGE models arrive at similar calculations of potential trade creation, as table 4 illustrates.

In a world of free trade, US imports of merchandise and services would expand by 14 percent, based on the model created by Brown, Deardorff and Stern (2001). Assuming that the European Union shared pro rata in this expansion, EU exports to the United States would increase by about $44 billion annually. Conversely, in a world of free trade, EU imports would expand by about 13 percent, again based on the model created by Brown, Deardorff and Stern (2001). Assuming that the United States shared pro rata, US exports to the European Union would increase by about $48 billion annually. Table 4 also calculates the potential increment in foreign direct investment stock, assuming a
fixed ratio between FDI stock and two-way trade in merchandise and services. US owned FDI stock placed in the European Union might expand by $109 billion (some 19 percent), whereas EU owned FDI stock placed in the United States might expand by $118 billion (some 15 percent).  

These calculations, based on CGE models, suggest that the elimination of barriers would significantly expand trans-Atlantic commerce. From such calculations, we conclude that large opportunities are at hand to enlarge trade and investment between the United States and Europe. But if the opportunities are so large, why are the actual conflicts so small? One answer might be that we are plain wrong: CGE models, gravity models, and kindred calculations may greatly exaggerate the scope of potential trade expansion. We disagree with this line of criticism, both because the story of the world economy for the past fifty years has been a story of enormous expansion in global trade and investment, and because nearly all scholars see room for considerably more growth with further liberalization.

As a logical corollary, we believe that trade and investment conflicts only pick at the edges of existing barriers. In order for commercial grievances to reach the level of negotiation, litigation or retaliation, generally two conditions must be met: an arguable violation of domestic or international norms; and a commercial interest in pursuing the case. Any number of US and EU barriers create commercial grievances -- just to cite two agricultural examples, US restrictions on cheese imports and EU restrictions on poultry imports. But in these cases and many others, while billions of dollars of trade are lost,
potential exporters cannot cite a violation of potential norms. The barriers are perfectly legal. In other cases, such as the EU coal cartel, or Alabama's generous subsidies to attract a Mercedes plant, norms are clearly violated, but no party has a commercial interest in prosecuting a case. In an even larger category, trade and investment barriers discourage commerce in ways that are barely discernable to market participants. For example, E-commerce involving small parcels has been stifled by tax clouds and high delivery costs -- but since the commerce never existed, it is not much missed by potential sellers.

We end this section, and turn to the recent conflict record (1990-2000), with a simple conclusion. As presently structured (and perhaps wisely so) the process of raising and settling conflicts can only remove a fraction of barriers that impede the potential leap in transatlantic commerce. What the conflict resolution process might do, however, is propel or impede cooperation that could, in time, lead to the trade and investment densities foreseen in CGE calculations.

**The Conflict Record**

Major commercial conflicts between the EU and US can be divided into three broad categories: market access, industrial policy, and ideology. Conflicts in the market access category concern specific restrictions limiting the importation of certain goods and services. Industrial policy conflicts are centered on the preferential treatment of domestic industries. Ideological conflicts have a commercial core, but they are inflamed by wider public concerns. Of course there is considerable overlap between the categories, but we
find a three-way classification useful for thinking about the historical conflict record and likely prospects for cooperation and convergence. Tables 5, 6, and 7 list some of the major disputes we have assigned to each category.

**Market Access Conflicts**

Disputes over market access reflect the traditional concerns of trading nations to hold their partners accountable for negotiated concessions; to some degree they also reflect grievances over the absence of reciprocal access. In addition to the never-ending steel saga, over the past decade the EU has complained about American tariff peaks in processed food (such as cheese), textiles, leather and glass, and about fish import quotas. The United States has complained about Europe’s labeling requirements for wine, duty rebates on rice imports, and the implementation of Uruguay Round commitments on grain. An increasingly prominent area of contention concerns restrictions in the trade of services, such as telecommunications, air transportation, shipping, broadcasting, and digital commerce. Further, both the EU and the US consider certain government procurement policies as overly protectionist. For the most part, these disputes have been relatively easy to resolve -- difficult to be sure, but decidedly less difficult than disputes in the industrial policy and ideological categories -- because market access disputes concern technical issues, such as tariff classification and the discriminatory application of fees, or because the given sectors are covered by ongoing negotiations, allowing for bundling and reciprocity. Consequently, disputes in this category have a relatively low public profile and are not severely disruptive to the overall transatlantic economic
relationship. A number of these disputes have been effectively addressed through the WTO dispute settlement mechanism (see Table 8).

A few years ago, the most prominent market access case involved bananas -- produced neither by the United States nor Europe, but entangling major US and EU commercial interests. The banana dispute was centered on a battle between four major distributors for slices of the economic rent (more than $1 billion a year) created by EU protection. The GATT and WTO found repeatedly that the EU quota regime for banana imports granted unfairly preferential access to signatories of the Lome convention. In 1997, the WTO ruled against the EU for a second time and stipulated that the regime should be conformed to international obligations within two years. The United States, unsatisfied with the EU’s proposed modifications, imposed 100% tariffs on imports worth $191 million per year on a rotating basket of goods, starting in March 1999. Challenged by the EU, the WTO upheld the legality of “carousel” sanctions in principle, yet ruled the particular sanctions illegal on a technical issue in July 2000. The considerable political fall-out from the banana case stemmed from Europe’s concern over the welfare of small producers in former colonial countries, from American indignation over the EU’s refusal to respect several WTO decisions, and from the novel policy of carousel sanctions. While EU and US trade officials settled the “official” dispute a year later, the “private” dispute lingers on. Chiquita Brands International and several smaller European companies are threatening to sue the European Commission for damages.
More recently, the Byrd Amendment signed into law in 2000, has become a target of vigorous EU market access complaints. The legislation provides that proceeds from anti-dumping and countervailing duty cases be paid out to US petitioner companies. Under this legislation, through December 2001, over $200 million had been paid to US petitioners (predominantly steel companies). Apart from the question of whether these payments are WTO-illegal subsidies, European officials insist that the Byrd Amendment creates strong incentives for private petitioners to bring questionable trade remedy cases.

The most recent market access dispute involves US “safeguard” restrictions against a wide range of steel imports. In March 2002, the Bush Administration imposed tariffs up to 30% in a flawed effort to revive bankrupt steel firms. This move drew instant criticism from the European Union, which estimates that it will suffer a loss of up to $2.5 billion in annual steel exports and worries that third countries, such as Korea, Russia and Ukraine, will divert their steel exports to Europe. Among its remedies, the European Union will bring a WTO challenge against US safeguard provisions, impose its own restrictions to prevent a surge in redirected steel imports, and has floated the idea of imposing landing right restrictions on foreign airlines receiving unfair state aid – notably American carriers which received $15 billion in federal aid in the wake of the September 11. European officials are verbally targeting US air carriers largely for negotiating purposes rather than out of genuine commercial concerns: there were little EU objections to the federal aid package when it was announced in the fall of 2001, and in any event US air carriers pose a limited competitive threat in the European civil aviation market.
Industrial Policy Conflicts

Disputes over industrial policy are far less tractable than disagreements over market access. Objectionable practices have been around for decades. Systems of agricultural support are the grandfather of all industrial policy disputes. The European Common Agricultural Policy (CAP) – with extensive subsidies both for production and exportation -- has created friction for forty years. The Uruguay Round was hung up for at least four years over provisions designed to discipline the CAP. Under the “peace clause”, the disciplines finally negotiated do not take full effect until December 2003. Meanwhile, US farm legislation swings between interventionist and market principles. For the major field crops -- rice, corn, soybeans, wheat and cotton -- direct subsidies are the chosen tool of intervention. The Freedom to Farm Act of 1996 enunciated market principles for several important crops, but the Congressional mood of 2002 calls for heavy intervention. This checkered record enables the EU to claim “you too” when European agricultural supports are challenged by the United States.

Another long-running industrial policy dispute centers on official export credits for shipments of industrial goods, primarily capital goods. Official export credit practices have been debated across the Atlantic since the 1970s. Since all industrial nations sponsor export credit agencies, the debate centers not over eliminating this particular brand of industrial policy, but rather the rules of the road. Multiple accords, starting with the "Gentleman's Agreement" of 1976, have been negotiated, with the United States, the European Union, Canada and Japan playing lead roles (see Hufbauer and Rodriguez, 2000). Yet new disputes are forever emerging. Thirty years ago the main concern was
interest rates far below commercial norms; ten years ago the main concern was "mixed
credits" (tied aid coupled with official export credits); today the main concern is "market
windows" (officially sponsored credit windows masquerading as private banks).

Industrial policy disputes are not, of course, confined to agriculture and export credits.
Both the European Union and the United States point to each other’s support for aircraft
manufacturing, whether direct subsidies or through military procurement, as unfair trade
practices. In shipbuilding, too, both parties have complained over protectionist policies in
the form of tax preferences, outright subsidies, and the required use of homeports for
major repairs. Another area of conflict concerns “off-limit” investment restrictions in
defense, television and airlines, whether justified by national security, culture, or
reciprocity.

Given the huge commercial scope of industrial policy on both sides of the Atlantic, it is
striking that few disputes in this category are actually brought for adjudication to the
WTO or the OECD. Nor do Europe and the United States engage in punitive retaliation
for one another's industrial policies. This is even true of contentious agricultural
questions: the agricultural disputes brought to the WTO generally involve second-level
questions, such as US rights when EU enlargement extends CAP restrictions to countries
where the United States had significant agricultural exports. Transatlantic retaliation
against the core elements of agricultural support policy has been practically unknown
since the famed (but now forgotten) "Chicken War" of the 1960s.13
One reason that the parties do not pursue litigation is that industrial policy measures, however offensive, may not involve a clear-cut violation of WTO (or previously GATT) obligations. OECD norms, in nearly every sphere, are expressly "non-binding" -- in other words, violating the norms gives the aggrieved party no adjudication rights. For example, military procurement from Boeing, even on generous terms, does not automatically translate (in the eyes of the GATT/WTO) into a subsidy for the manufacture of 747 civilian aircraft. Likewise, CAP support for oilseed farmers in northern France does not automatically translate into an injurious domestic subsidy. Nothing in the WTO or the OECD requires Italy to license ABC if it wishes to establish a TV affiliate in Milan. Nothing in the OECD Agreement on Officially Supported Export Credits forbids mixed credits; the United States can only resort to matched financial offers when its exports are disadvantaged by Italian mixed credit schemes.

But there is a more fundamental reason why industrial policy disputes do not generate either WTO litigation or punitive retaliation. The aggrieved country finds it hard to envisage a satisfactory outcome from either strategy. The offending country is not likely to abandon an industrial policy rooted in domestic political priorities. Pressed to the wall, however, the offending country is very likely to point at comparable industrial policies on the other side of the Atlantic. Indeed, since a common political response to industrial policy abroad is rough emulation at home, there is almost always something to point at. Home beneficiaries of industrial policy are usually more anxious to retain the assured benefits of domestic support programs than to seek the uncertain benefits of industrial policy disarmament. On the other hand, finance ministries generally want to reduce the
budget costs of industrial policies, while trade ministries would like to resolve commercial friction. The result is a *modus vivendi*: costly industrial policies coexist on both sides of the Atlantic, accompanied by protracted negotiations aimed at clarifying the rules of the road and perhaps phasing down levels of support.

A current high-profile industrial policy conflict revolves around the US Foreign Sales Corporation (FSC) legislation. The FSC was enacted in 1984 to replace the Domestic International Sales Corporation (DISC), a tax-deferral vehicle that had been ruled GATT-illegal (along with the export features of European territorial systems) in 1976. The FSC legislation -- providing a partial exemption for a *foreign* export sales subsidiary rather than deferral for a domestic export sales subsidiary -- went unchallenged throughout the Uruguay Round. In the mid-1990s, the European Union threatened to bring a FSC case before the WTO to stave off a looming US challenge over government subsidies for Airbus. That episode passed, but in 1997 the European Union did launch a FSC case largely in response to aggressive American tactics in the banana and beef hormone disputes. The WTO Appellate Body ruled for the European Union in 1999; the United States then replaced the FSC with the Extraterritorial Income Exclusion Act (ETI) of 2000; the European Union brought a second case, and the WTO Appellate Body ruled against ETI in 2002. The European Union claims retaliatory rights of $4 billion while the United States says the retaliatory figure should be capped at $1 billion. The WTO Arbitral Panel will give its award in late April 2002. The European Union will then puzzle how best to use its outsized negotiating chip, while the Administration and Congress will puzzle how to amend US tax law so as to meet WTO obligations yet not
disadvantage US exporters. The EU puzzle seems somewhat easier to figure than the US puzzle.

The EU attack on FSC/ETI has less to do with the competitive dimension of industrial policy (carried out through tax provisions) and more to do with negotiating tactics. Indeed, many European multinational companies benefit, through their US subsidiaries, from the FSC/ETI. Moreover, if the United States were simply to adopt a European style territorial system for taxing foreign source income, and give exporting firms the benefit of the doubt in transfer pricing cases (as often happens in Europe), US exports would enjoy far larger tax incentives than DISC, FSC or ETI ever provided. If anything, the FSC/ETI saga will end up reinforcing rather than dismantling industrial policy writ large. Once the WTO judicial mill awards Europe an FSC/ETI negotiating chip that is far larger than the outstanding US beef hormone chip ($1 billion or $4 billion vs. $300 million), the EU strategy is to pray that the Administration and Congress cannot escape their own dilemma of satisfying an international obligation in the face of domestic demands. The EU will then use the FSC/ETI chip to stave off a fresh round of aggressive American attacks on core elements of the CAP. In other words, the big bargain is a *modus vivendi* on farm supports in exchange for a *modus vivendi* on tax preferences.

**Ideological Conflicts**

Ideological disputes are not, of course, devoid of commercial questions. What sets an ideological conflict apart is that the dispute spills well beyond commercial issues. A sure sign that a commercial dispute has evolved into an ideological dispute is protracted
attention on TV talk shows, and hostile notice from "public interest" NGOs, such as Greenpeace, the Sierra Club, or Public Citizen. The extra spotlight makes these disputes hard to resolve.

Since the 1950s, individual European nations and more recently the European Union as a body have objected to the extraterritorial application of US law. Early cases involved the assertion of long-arm US antitrust jurisdiction against British companies, and application of the Trading with the Enemy Act to US controlled subsidiaries operating in France.

The long-standing European complaint about "unilateralist" US tendencies was again provoked by the “Super 301” and "Special 301" provisions of the 1988 Omnibus Trade and Competitiveness Act of 1988. These provisions, which amplified the Section 301 provision of the Trade Act of 1974, authorize (indeed, practically insist) that the Administration investigate foreign trade practices alleged to be discriminatory or unjustifiable, and in appropriate cases initiate retaliatory measures without prior recourse to the GATT. Several USTR investigations were directed at the European Union, and two notable examples involved market access for modified starch and export subsidies on processed cheese. Few people in Europe or the United States could recite the products involved, but the ideological dispute was well rehearsed. The ineffectiveness of GATT dispute settlement procedures led many US observers to insist that unilateral retaliatory measures were required to ensure compliance with trade obligations. European observers, on the other hand, insisted that no country should act as both prosecutor and judge in determining whether trade obligations existed and whether they were faithfully
observed. In this instance, the ideological dispute was resolved with the creation of a new -- and far more forceful -- Dispute Settlement Mechanism (DSM) in the World Trade Organization, and the unofficial retirement of Section 301 and its progeny when the Uruguay Round accords were ratified by the US Congress in 1994.

More recently, the Iran-Libya Sanctions Act of 1996 (ILSA) inflicted penalties on foreign companies investing more than about $20 million in the oil industries of Iran and Libya, states viewed as sponsoring terrorism by the United States. ILSA was immediately challenged by the European Union, and since its enactment the proposed sanctions have episodically provoked transatlantic debate. The threatened penalties are actually modest, and in any event the Clinton Administration waived their application. But the larger ideological issues -- well before September 11 -- were the appropriate characterization of Iran and Libya, and the best way of dealing with the regimes. On these issues, there is little common ground between the United States and Europe.

Similarly, the Helms-Burton Act of 1996 threatened sanctions against foreign firms taking advantage of expropriated American property in Cuba. Soon after the legislation was enacted, the European Union initiated a WTO case. Intense shuttle diplomacy between Capitol Hill, the White House and Brussels, capped both by an EU declaration of principle against "trafficking" in expropriated property and a waiver from the Clinton Administration, both kept the dispute off the WTO's active calendar and quieted the debate. The amount of expropriated property and the size of threatened penalties were
both modest, but the ideological issue was huge: how to deal with Fidel Castro and the Cuban people.

Almost from the start, the Multilateral Agreement on Investment (MAI) was caught up in the transatlantic acrimony surrounding ILSA and Helms Burton.\textsuperscript{16} MAI negotiations were launched at the OECD in May 1995, and Europeans shortly, if rhetorically, asked whether these sorts of secondary sanctions would be ruled out by the MAI. Another ideological dispute quickly rose to prominence: would "cultural industries" be entitled to a blanket exception in the MAI (as demanded by Canada and France), or only specific exceptions enumerated in each country's schedule (demanded by the United States). While the negotiators were groping for a solution to this question, NGOs began to pile on with another ideological claim: the MAI amounted to "NAFTA on steroids" in terms of its investor protection provisions. Playing to these ideological debates, France withdrew from the MAI talks in October 1998, and they collapsed soon after.

The most prominent case brought to the WTO by the United States against the European Union involves the EU’s ban on imports of all live and processed animals treated with growth hormones. The controversy dates back to the mid-1980s, but prior to the Dispute Settlement Mechanism (DSM) of the WTO, there was no effective way for the United States to litigate the issue. In 1998, the WTO ruled that the EU prohibition was illegal, because it was not based on scientific evidence. The European Union refused to lift the ban, and the United States retaliated against $117 million of EU exports.
Public opinion in Europe is dead set against lifting the ban. In bilateral negotiations the European Union has even ruled out a US proposal to segregate and label hormone-treated beef as a compromise that would enable European consumers to decide what they want to eat. Instead, Europe has advocated a "precautionary principle" in WTO rules -- biotechnology imports could be banned unless proven that they cannot harm any person, animal or plant in the importing country. Clearly there is an enormous ideological gulf between a rule that requires scientific evidence to impose a ban, and a rule that requires proof of innocence to lift a ban.

The same ideological divide permeates other biotechnology cases. The United States, citing the absence of BSE in America, objects to a comprehensive EU ban on the importation of BSE-related Specific Risk Materials. More charged (and of far more commercial consequence) is the debate over Genetically Modified Organisms (GMOs). Unlike growth hormones, GMOs are not banned in Europe. However, contrary to the American attitudes, they meet with considerable public skepticism among Europeans. In principle, the European Commission could authorize the sale of GMOs. But given the strong opposition of some member states, the EU has observed a moratorium on the approval of GMO products for the past three years. Exports of genetically modified corn from the United States to Europe have been suspended, and 13 other US products are stuck in the pipeline of regulatory approval.

In the face of European reluctance to proceed with GMO approval, USTR officials have recently indicated a willingness to consider bringing a case to the WTO. European
companies share an interest with their American counterparts in speeding EU regulatory approval. Yet a ruling by the WTO against the European Union will no more resolve the GMO issue than the growth hormone issue. The chief obstacle is widespread fear among Europeans that GMOs will harm them, their children, or their environment. Reflecting these fears, some member governments staunchly refuse to accept the use of GMOs.

**Outlook for Cooperation & Convergence**

The decade of the 1990s highlighted in our account spans three presidencies in the United States, and alternate Democratic and Republican control of the House and Senate. It also spans two major leaders in the European Union (Jacques Delors and Romano Prodi), and significant shifts between conservative and socialist leadership in the major European nations. In other words, the 1990s were years of normal political turnover in advanced democratic nations; accordingly the record of transatlantic conflict management was not dominated by just a few idiosyncratic personalities. Instead, the record provides a relatively normal baseline for what might be expected, in the absence of major political upheaval in the United States or Europe.

*Forecast based on the 1990s*

Using the conflict record of the 1990s as a baseline, we distill two major forecasts. First, the outlook for cooperation is good -- in the limited sense of resolving run-of-the-mill market access disputes and keeping industrial policy and ideological disputes from escalating. Second, the outlook for policy-driven convergence is poor: economic
convergence would require far greater progress in resolving industrial policy conflicts. Resolution of ideological conflicts would contribute to a sense of transatlantic harmony, but it is not essential for economic convergence. This is fortunate, because few ideological conflicts are susceptible of resolution through negotiations among trade and finance ministries.

The Doha Round should bring average industrial tariffs on transatlantic trade under 3 percent. Peak tariffs will persist on sensitive products, but mainly to protect EU and US industrial producers from Asian competition. In other words, transatlantic market access will be improved, but nothing like a transatlantic free trade area will emerge from the Doha Round. Market access conflicts in the future, as in the past, will concentrate on the margins of CAP, unfair trade cases, and behind the border barriers created by technical standards on goods and services with a low political profile (such as telecommunications equipment and mutual funds).

Based on the record of the 1990s, and the limited achievements in the Uruguay Round, it seems unlikely that the Doha Round will bring substantial convergence on industrial policies. Progress may be made on limiting (to a modest degree) agricultural support measures, and pointing them in a “green” direction. Progress may be made on leveling the rules for taxing export earnings. Modest additions to the list of covered entities under the Government Procurement Code may be achieved. But in these and other areas of industrial policy, the watchword is “modest”, not “substantial”. At the same time, it
seems unlikely that industrial policy conflicts will erupt in trade wars. In the future, as in the past, a prickly *modus vivendi* will characterize transatlantic relations.

The outlook for negotiated solutions to ideological conflicts is, if anything, less bright. Fidel Castro, Moammar Gadhafi, and the ruling clerics of Iran may pass from the scene and take with them those particular transatlantic conflicts. But the conflicts will not be resolved by quiet negotiations in Washington, Brussels or Geneva. Fortuitous events and evolving public attitudes, not the OECD and the WTO, hold the key to ideological conflicts. Fortunately, as we said earlier, economic convergence does not depend on resolving ideological disputes. Massachusetts and Virginia hold very different views about the death penalty, abortion, school vouchers, stem cells and other social issues, but those differences have little impact on commerce between the two states. While transatlantic ideological conflicts have interrupted some commerce, so far the impact is slight. We are optimistic that future trade and finance ministers will succeed, as their predecessors have done, in damping the economic fallout from ideological conflicts.

To summarize, our forecast stresses continuity rather than change. Conflicts will erupt, and on market access questions they will be resolved. On industrial policy and ideological questions, they will be contained. Economic convergence between the United States and Europe will be driven at least 75 percent by market forces, and at most 25 percent by policy initiatives.
A More Ambitious Agenda?

Our forecast is "business as usual", but in case US and EU leaders want to push economic cooperation and convergence at a faster tempo, we have a few recommendations. Our first recommendation is to keep up the good work on market access disputes. The transatlantic partners should bring cases to the WTO on an expeditious schedule; when disputes fall outside WTO jurisdiction, they should establish *ad hoc* arbitration panels; and when the WTO Dispute Settlement Mechanism or *ad hoc* arbitration panels render a verdict, they should implement the decisions. For example, when the WTO rules against the United States in the Section 201 steel case, as will happen later this year, the United States should quickly eliminate the offending tariffs.

Our second recommendation is to let ideological disputes run their course, managing and damping the economic fallout, but not devoting extraordinary official effort to finding an swift resolution. In most ideological disputes, the NGOs, the concerned public, and the media have no real interest in an expeditious resolution. They want to ventilate; and government officials should give them plenty of time and space to do just that. Besides, the economic stakes in the ideological disputes so far have been relatively small.

Our third recommendation is to concentrate on the industrial policy disputes. Here the economic stakes are large, but fortunately the disputes are at least 70 percent about money and 30 percent or less about ideology. That's not to say the disputes are easy to resolve; but it is to assert that hard negotiations in which rational actors motivated by economic interest are the central players are likely to prove productive. Obviously, the results must respect an economic balance between Europe and the United States, and this
basic consideration will require a packaging of issues. We conclude our recommendations at this juncture, confident that responsible ministers -- if they accept our analysis -- can assemble better packages than we can.

References


**Endnotes**

1 Gary Hufbauer is the Reginald Jones Senior Fellow at the Institute for International Economics. Frederic Neumann is a former Research Associate at the Institute for International Economics, and a graduate student at Johns Hopkins School for Advanced International Studies. The opinions expressed are the views of the authors, and do not necessarily reflect the views of the Institute for International Economics.

2 Scollay and Gilbert (2001) suggest that the increase in US imports would be 16 percent (table 4).

3 Scollay and Gilbert (2001) suggest that the increase in EU imports would be 10 percent (table 4).

4 These figures are based on the trade estimates made by Brown, Deardorff and Stern (2001).

5 Similar inferences can be drawn from gravity models of trade, and McCullum-style comparisons of intra-national and international trade. See, for example, Frankel and Rose (2000) and Helliwell (2001).

6 For this kind of skepticism see, for example, Dorman (2001).

7 For background analysis, see Hufbauer and Goodrich (2002).
Interventionist principles -- expressed through allocation rights and border barriers -- are the norm for dairy and “minor” crops such as tobacco, sugar and peanuts. The swing between intervention and market principles is most pronounced for the major field crops. More than 90 percent of direct federal subsidies go to farmers who raise the major field crops, rice, corn, wheat, soybeans and cotton; and 45 percent of this largesse goes to the largest 7 percent of farms. Edwards and DeHaven (2002).


For a concise history of the Chicken War, and its unintended consequences, see Jackson and Davey (1986).

For a short historical outline, see Hufbauer (2002).

This account is based on Graham (2000), the best account of the MAI saga. As Graham points out, the NGOs did not play a decisive role in collapsing the negotiations (as the NGOs tried to claim), but their limited role was a useful dress-rehearsal for the much greater NGO rampage at the WTO Ministerial held in Seattle a year later.

For a comprehensive analysis of the GMO case see Josling (1999)