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FOREIGN TRADE

Current EC-US Economic Conflicts

by Dieter Lösch, Hamburg*

The danger of serious disagreements on the agricultural question and a trade war developing between the EC and the USA may never have been as great as it is today: on the one hand, the EC has less and less leeway for its foreign trade policy because the problems in financing its agricultural policy are still unsolved and, on the other hand, no major concessions can be expected of the Reagan administration in an election year. Yet agriculture is only one of a series of fields of economic activity where Euro-American collisions are continually occurring.

Ever since the foundation of the European Community, which could not have happened without any agreement on a common protectionist agricultural policy, trade in agricultural produce has been a problem area in transatlantic relations. With agricultural surplus production growing on both sides of the Atlantic, this smouldering conflict has repeatedly threatened to degenerate into an outright trade war. The agricultural conflict can be attributed to the following causes:

□ The agricultural lobby's position is extraordinarily strong both in the USA and in the EC. Renewed evidence of its strength in the EC came at the end of 1983 when the European Summit Conference in Athens foundered on the question of agricultural policy reform, and even now it is impossible to see how the necessary reform in EC agricultural policy can be brought about without precipitating a serious crisis in the Community. In the USA, the agricultural lobby has always exerted a considerable influence on the government of the time, and especially on conservative administrations.

□ As a result, agriculture receives support from the state in both the EC and the USA. However, the support systems are fundamentally different: the EC guarantees high prices for most agricultural products by way of intervention buying; in the USA, on the other hand, farmers are mainly directly subsidised, allowing agricultural prices to find their level through market supply and demand, without any state influence through demand support. The American system has the advantage that market prices do not give any extra encouragement to production, whereas the European system of guaranteed minimum prices has meant that the domestic EC market had to be fenced off from the outside world, and has also had the inevitable

consequence that the present-day European agricultural policy can no longer be financed in its existing state.

The Americans have been pushing for a revision of European agricultural policy for years, although they have always professed their understanding for the fact that it could not be completely turned around overnight. Their objections are aimed at the *amount of agricultural support* the community provides, at the *agricultural protectionism* it practices, and particularly at the *subsidising of agricultural exports* to third countries:

□ As far as the level of agricultural subsidies is concerned, the Europeans point out that EC expenditure amounts to \$ 4,780 per farm per year, as against \$ 7,330 in the USA. The USA's response to this is that the average US farm is ten times the size of the average EC farm; thus, they say, the annual support provided per acre of cultivated land is only \$ 17 in the USA against \$ 120 in the EC.

□ The EC counters the Americans' argument that insufficient foreign produce is allowed into the Community by pointing out its agricultural trade deficit with the USA, which in 1980, for example, was more than \$8.4 billion. The EC also draws attention to the fact that it distinctly favours developing countries' agricultural exports to the EC under the terms of the Lomé Agreement with the ACP countries.

□ In reply to the USA's criticism of its export subsidies, the EC points out the export credit guarantees and interest-free or low-interest loans the USA itself provides to encourage its exports to developing countries, and pleads that the EC's exports to third countries have risen less strongly than the USA's. Furthermore, the argument runs, the EC's export support is not in contravention of the GATT.

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The Current Agricultural Trade Conflict

The agricultural conflict which had been smouldering for many years between the EC and the USA has taken a considerable turn for the worse since November 1982. This was the time when, at the USA's instigation, a committee of investigation was set up under the auspices of the GATT to check whether the EC's alleged wheat flour dumping activities were consistent with the GATT treaty. In parallel to this, the USA threatened the EC with retaliatory measures unless it changed its subsidising practices. When the GATT committee concluded in late February 1983 that the EC practices were not contravening the treaty, the Americans declared their intention to start their own massive wheat export subsidies if the EC failed to limit its subsidised exports. To demonstrate its resolve to launch into a trade war, the USA had already gone ahead with the sale of a million tonnes of wheat flour to Egypt at \$155 per tonne – \$25 per tonne below the world market price; not only that, but the US government had also granted Egypt a low interest loan to finance the purchase. The USA backed this up by threatening to continue with further sales in ten more countries (including five traditional EC markets, namely Portugal, Yugoslavia, Morocco, Pakistan and Yemen), which would be subsidised to a similar degree, if the EC were not prepared to come to the negotiating table and discuss a change in its agricultural export policy. The USA's final threat was that it would sell subsidised butter, and one presumed this would also be to previous EC customers such as the Soviet Union.

France in particular was affronted by the USA's behaviour. President Mitterand, speaking to a farming audience, went as far as referring to these developments as economic imperialism on the part of the USA. Until the American move, Egypt had been importing about 700,000 tonnes of wheat annually from the EC, of which 90 % came from France. Yet the trade war which was at first feared, and could easily have spread to the poultry and egg markets which had been scenes of earlier severe conflicts between the EC and the USA, did not, after all, materialise in 1983. Evidently reason prevailed on both sides, but especially in the USA, when they saw that a trade war of such proportions could be certain to bring no gain to the opponents involved, but that third parties, particularly the world's largest agricultural importer, the USSR, would have the last laugh. Obviously it was also realised on this side of the Atlantic that there is nothing to gain from a trade war with the USA. In spite of all the belligerent rhetoric, then, the parties were at pains not to allow the conflict to escalate any further. Negotiations

were begun, but when they ended in mid-1983 they had brought the meagre result of a mutual agreement to set up a working group which would study the various national methods of granting subsidies.

Immediately afterwards, the conflict did escalate again as the USA announced the intended sale of 18,000 tonnes of butter and 6,000 tonnes of cheese to Egypt, aided by a loan with a three-year grace period and repayable in Egyptian currency as well as by price subsidies. This was seen in EC circles as a renewed American attempt to break into a traditional European export market. On the other hand, the EC had already made an announcement in the context of its agricultural reform proposals that it wished to introduce a tax on cooking oils and fats and impose quotas on imports of feedstuffs (cereal substitutes, principally maize gluten feed) into the Community. Taken together, the two measures would substantially affect American exports to the EC amounting to almost \$4.5 billion even though there is little to link the measures with direct protectionist motives; rather, they result from the urgent need to reduce the amount spent by the community on subsidising agriculture, something it is hoped to achieve both by raising milk producers' input costs and by raising the prices of products which compete with butter.

The agricultural conflict between the two economic powers has again risen to a dangerous pitch since the EC's declaration of intent in October that subsidies on grain exports to Egypt would be raised by 10 % (from \$62 to \$68 per tonne) for the period December 1983-July 1984, to allow the community to win back its traditional market. Although a conversation which took place between the US Secretary of State and the EC Commissioner for Agriculture on 9th December 1983 was most committal in tone, it did not bring any rapprochement between the respective stands. The danger of serious disagreement on the agricultural question and of a trade war may never have been as great as it is today: on the one hand, the EC has less and less leeway for its foreign trade policy because the problems in financing its agricultural policy are still unsolved, and on the other hand, no major concessions can be expected of the Reagan administration in an election year.

US Steel Protectionism

The Euro-American steel controversy, too, has become much more severe in the past year, though in this case the positions occupied in the agricultural conflict are reversed. It was the Americans who took unilateral protectionist measures, and on the basis of their continued unwillingness to yield to the EC's

resultant demands for compensation, the Community resorted to retaliatory measures.

The steel conflict between the Atlantic trading partners can be attributed to the fact that the industry, both in Europe and in the USA, is in the midst of a serious structural crisis. There are enormous capacity surpluses on both sides of the Atlantic.

□ The eight traditional American steel majors have come under increasing pressure in recent years from more productive small-scale domestic producers, who have managed to increase their market share from practically zero in 1981 to 20 % today. At the same time an increasing amount of foreign steel (not only from the EC!) has been pushing its way onto the shrinking American market. The main problem the great American steel corporations face is a preponderance of obsolete production facilities; not only do they incur higher production costs than those of the competition, but they also turn out poorer quality steel. The American steel industry is therefore demanding strict protection from foreign competition, the suspension of relevant environmental protection laws, special exemption from anti-trust legislation in their sector, and subsidies amounting to billions of dollars.

□ The EC also has considerable surplus capacity in the steel sector. However, the picture from country to country is not a uniform one. Some, like West Germany and Italy, modernised their steel production in good time. Other countries, with France as the prime example, built up massive surplus capacities with the help of the state, and for years now have been subsidising loss-making operations on a national basis. Up to the beginning of 1983 alone, the EC's steel industry is said to have received a total of more than DM 80 billion in subsidies. A crisis arrangement between EC members has been in operation since mid-1980, according to which the Community approves state subsidies and distributes production quotas. On 1st January 1984 minimum prices came into force for the most important rolled steel products, backed up by import controls freezing imports into the EC at the level of "traditional delivery volumes", and by a compulsory deposit scheme intended to prevent any infringement of the price regulations. The aim of these measures is to coordinate the necessary reduction in capacity over the medium term.

The Development of the Steel Conflict

As long ago as 1981, the American steel industry took legal action against several of its opposite numbers in the EC for dumping their products on the American steel market. As evidence of this they cited the massive steel

subsidies in a number of EC countries. The Community's argument was that the subsidies were not intended to encourage exports, but to aid the restructuring of the industry. Nevertheless the US Department of Commerce heeded its own steel industry's dumping argument and imposed provisional countervailing duties on American steel imports from the EC. However, before these had officially taken effect the USA and the EC agreed to a compromise involving a "voluntary" reduction of 10 % in the EC's steel exports to the USA. The compromise formula was initially rejected as insufficient by the American steel industry federation. Yet the procedural rules surrounding the dumping suit meant that the compromise agreement would not be able to be put into effect without the federation's approval, so bargaining over a new compromise went on for several months. It was eventually found in late October 1982, taking effect on 1st November 1982, and valid until the end of 1985. The agreement comprises a voluntary ceiling on the EC's share of the US market for ten types of ordinary steel; the agreed market shares vary from 2.2 % for tinplate to 20.85 % for sheet steel pilings.

One area left open when the above compromise was drawn up was the Americans' complaint that the Europeans had been dumping several different types of special steel. Thus as early as January 1983 legal complaints ensued against a number of European companies (including British, French, Italian and German firms). At the end of April the International Trade Commission (ITC) finally recommended that the USA should introduce import quotas for a number of special steels, referring in its recommendation to the subsidising practices of foreign competitors in the US steel market.

On the strength of this recommendation the US President laid down tariffs and import quotas in July 1983 for certain types of special steels: tariffs of 8 % were set for the import of stainless steel plate, and 10 % for stainless strip and rolled steel; quotas were imposed on the import of steel barrel, steel rods and certain alloy steels. Whilst it is intended to raise the tariffs by 10 % annually over the next four years, provision has also been made to dismantle the quotas in stages over the same period.

This protectionist move which came only a matter of weeks after the world economic summit in Williamsburg brought a cry of protest from the countries affected. The EC determined that it would file a compensation claim under the provisions of the GATT. This demand for compensation was also recognised in principle by the

US government. As provided under Article 19 of the GATT, negotiations over US compensation payments got under way, in which the EC's original demand amounting to \$570 million spread over four years was reduced to \$400 million; the Americans for their part offered a mere \$4 million. Given the failure to agree, the EC brought retaliatory measures into effect on 15th January 1984: the tariffs on methanol and vinyl acetate were increased.

The US Budget Deficit

At the Williamsburg economic summit in mid-1983, the Europeans tried with the support of Japan to exert sustained pressure on the US government to reduce its budget deficit and thus establish the conditions under which American interest rates could be lowered. For the high interest rates prevailing in the USA were regarded as the main obstacle to interest policies in the European countries which might be more appropriate to the level of economic activity. The US delegation initially disputed the link not only between the budget deficit and interest rate level in their own country but also between US and European interest rates; however, they did eventually ratify the closing communiqué committing all the conference participants to roll back any structural budget deficits. The declaration's actual words were that the countries involved would "aim, preferably through discipline over government expenditures, to reduce structural budget deficits and bear in mind the consequences of fiscal policy for interest rates and growth".

Yet in the 1982/83 fiscal year the US budget deficit reached \$195 billion and the budget draft put before Congress in February 1984 for the period 1984/85 again involves a deficit of almost \$185 billion which, given that this is an election year, will presumably turn out to be even higher in practice.

As the enormous budget deficit in the USA absorbs a major part of private saving, hence at least contributing to persisting high interest rate levels, which then are a factor in the obvious over-valuation of the dollar, which again hampers American exports and thus aggravates the current account deficit, there is a danger that existing protectionist tendencies in the USA will be given fresh impetus, and that in the election year ahead the government will at least partly bow to these tendencies.

East-West Economic Relations

In the period of détente in the 1970s East-West economic relations were not a point at issue between the USA and the countries of Europe. This position changed drastically while President Carter was still in

office, when the USA pronounced economic sanctions against the USSR because of its invasion of Afghanistan, without any prior consultation with the Europeans. Once the Reagan administration had taken office, deep-seated differences of opinion on questions of East-West economic relations emerged between the USA and its European allies which reached beyond the sanctions problem itself.

The Reagan administration has a very sceptical stance on East-West economic relations which meets with opposition not only in Europe, but also among US exporting businesses. However, this American lobby seeking unencumbered economic relations between the Eastern bloc and the West is limited in its influence and major differences of opinion therefore remain between the US government and the Europeans, whose interests in relations with the East can be attributed to similar economic factors, but to political factors as well.

Quite apart from differences of political viewpoint, the conflicting opinions on East-West relations are understandable in the light of structural differences between the two sides' trade relations with Eastern Europe: the EC's exports to the Eastern bloc in 1981 were more than twice those of the US and Japan put together, and three-quarters of those EC exports comprised high-value industrial products and chemicals. Almost three-quarters of the exports from the USA, on the other hand, which in total were less than a quarter of the EC's shipments to the Eastern bloc, were made up of agricultural products.

The USA's prime objections to Europe's East-West economic relations are as follows:

- That the EC not only exports too much to the Eastern bloc but also the wrong type of goods. These exports reputedly strengthen the bloc's military power, directly or indirectly. The USA's agricultural exports to the region, on the other hand, are said to use up their valuable convertible currency reserves.
- That the volume of trade between the community and the East carries a hidden danger of Western Europe becoming too dependent on the East, and especially on Soviet exports of natural gas. This, they say, means Western Europe is becoming politically vulnerable.
- That if Western Europe becomes dependent to this degree the West as a whole, in the US government's view, would find it difficult or even impossible to impose sanctions on the Soviet Union which might be considered politically necessary in the future.
- That the Soviet Union's military might is being perilously strengthened, especially by importing

modern Western technology. Exports of technology to the Eastern bloc ought therefore to be reduced and more effectively supervised.

□ As far as imports from the Soviet Union are concerned there is another objection in addition to the dependency argument, namely that the USSR can use the resultant foreign currency earnings to import modern technology through the back door, routing the trade through third countries and avoiding American and Western export restrictions (the COCOM list).

□ The US government initially criticised the practice of a number of EC countries (France is one example) of granting state-subsidised loans, primarily intended to stimulate exports, to Eastern-bloc countries (the USSR in particular). When the Europeans complied on this point under the Americans' insistence, the USA began to criticise the whole principle of granting credit to the Eastern bloc in convertible currency. Such loans, the argument ran, would in the first place add to the Soviet Union's economic strength, and therefore to its military strength; however, they were also subject to the risk of not being repaid, given the weak export performance of the Eastern bloc and recent experience with Poland and Rumania; this, said the USA, when added to the major debts of developing countries, would be a further danger to the international monetary system.

The EC countries are virtually unanimous, even though there are often great differences in emphasis, in putting forward these points in opposition:

□ East-West trade should not be treated any differently from trade with Western or non-aligned countries. Although the Europeans are also aware of the problems bound up with exporting high technology, these, they say, are equally pertinent to trade with other third countries and could be kept under control in the same way, namely by way of state export licences and controls based on a COCOM list which is not unduly extensive or complicated.

□ In as far as economic relations with the Eastern bloc generate a certain amount of *mutual* dependence, this has a contribution to make to *détente* given that both sides have an interest in continuing and expanding the exchange of goods; an accompanying increase in the amount of mutual contact helps to improve the political climate and create more trust between the two sides.

□ With this in mind, Soviet political misdemeanours should not be answered with economic sanctions, especially as these have always proved ineffective in the past, and have in fact back-fired to affect Western interests.

Controversies have developed in the past between the USA and the EC on the following points of detail, not all of which have been cleared up:

The Natural Gas Pipeline Project

It is generally acknowledged that the conflict surrounding the natural gas pipeline project brought the most serious discord for years between the USA on the one hand and West Germany, France and Britain on the other. The USA objected to the deal on the grounds that (1) the construction of the pipeline from Siberia to Western Europe was being financed far too cheaply with European loans, (2) the Soviet Union would also be able to use its ability to cut back the supply of gas as a means of applying political blackmail and (3) in case of war the cutting off of gas supplies would reduce Western Europe's ability to defend itself.

The European countries concerned made clear their own position that Europe was unavoidably dependent on energy imports and that a Soviet contribution of about 15 % of European gas supplies – about 5 % of total energy consumption in the Community – would not amount to excessive dependence. Furthermore, emergency plans were in preparation to provide for any possible interruption of supplies from the USSR.

The USA showed no signs of being impressed by these arguments, and its reaction was to try and delay the pipeline's construction by imposing an embargo on American components, including such components manufactured under licence in Europe. This once again caused much bad feeling among the Europeans, even though for the most part the measures were ultimately withdrawn. Meanwhile the conflict appears to have calmed down with the passage of time, to the effect that the USA will make no further attempt to obstruct the natural gas pipeline project, whilst the Europeans will not consider any further major cooperative projects with the Soviet Union for the time being.

In December 1983 the time came to pass the highly controversial amendment of the 1979 Export Administration Act which in the meantime had expired. The US government had originally intended to make this law much harsher. Among the proposals were bringing foreign subsidiaries of US corporations into the ambit of the law and providing for the possibility of sanctions against foreign businesses – the latter would involve, for example, blocking these companies' exports to the USA or placing a prohibition on any deliveries to them of US high technology products. However, the law was not ultimately tightened up in this way, partly no doubt as a result of strenuous protests from the Europeans who

above all regarded the planned extra-territorial effect the law would have had according to the original proposal as a gross infringement of international law and a violation of their own sovereignty. Thus a further point of issue between the USA and the EC was laid to rest for the present.

Loans to the Eastern Bloc

At the Versailles economic summit, the Americans urged the Europeans to commit themselves to certain minimum rates of interest below which export credits for Eastern-bloc countries would not be subsidised, and generally to restrict the granting of export credit in East-West trade. The USA intimated that if the Europeans were to concede this point, it might reciprocate by tolerating the natural gas pipeline deal. However the concession was not forthcoming, so President Reagan was able to step up the embargo directed against the pipeline project with a clear conscience.

Soon after the Versailles conference, however, agreement was indeed reached under the auspices of the OECD that East Germany, the USSR and Czechoslovakia would now be placed in Category I – namely, the category of industrial nations – bringing higher minimum interest rates into force for those countries. However, because the stipulated minimum rates only retain their validity for as long as market interest rates for a comparable term are higher or equally high, there is naturally a certain amount of leeway available for circumventing the agreement.

A question which remains open is the provision of state guarantees for trade credits with the East. The USA believes guarantees of this kind should not be made in favour of communist countries, and certainly not for those in Category I. The European countries have different practices in providing credit guarantees. However, they would be both unable and unwilling to accept political criteria for these decisions. On this point, then, it will be difficult for the parties on either side of the Atlantic to reach a harmonious viewpoint.

COCOM Negotiations

The scale of differences of opinion over the COCOM¹ list (the list of high-technology products with potential military applications which may not be exported to the Eastern bloc) is still at present unclear. The USA wishes to expand the list, to improve the monitoring of high-technology exports to the Eastern bloc, and to amend the COCOM consultative procedure which so far has been informal in nature and based entirely on

unanimous decision-making. Evidently the US Department of Defense tried to push through a decision to set up a permanent sub-committee of the COCOM committee, largely made up of military personnel. This led to a series of internal rows last year between the Pentagon and the State Department culminating with the Director's resignation at the State Department's Office of East-West Trade on the grounds that it would be impossible to force the formation of such a sub-committee within the COCOM consultative framework upon the European countries.

The agreement reached at the conclusion of the last round of negotiations was that the individual countries would each work out proposals of their own for extending the COCOM list. The next round of negotiations is scheduled for April 1984. Because various statements from the American side have suggested that the USA would like to be able to bring all East-West trade under more effective control by enhancing the role of COCOM consultations, and because this is something the Europeans are not willing to accept, a rather tough dispute can be expected which may well have a marked adverse effect on the climate between the USA and its European allies.

Concluding Remarks

This survey has only addressed the most immediate and pressing areas of conflict between the USA and the EC which are either caused by or relevant to economic activity. There are a series of other differences of opinion over matters such as the West's willingness to show accommodation in the so-called North-South dialogue, the accession to the International Convention on the Law of the Sea, the attitude to the UN organisations where the developing nations are in the majority, problems relating to the International Monetary Fund, and a number of other areas of difficulty.

This kind of conflict of difference of opinion is in fact quite normal between friendly, allied nations, and further instances can certainly not be ruled out for the future. The potential conflict areas discussed above have not as yet – with the possible exception of the natural gas pipeline dispute – led to any fundamental deterioration of mutual relations. As a general rule, conflict management has functioned, even if this was not without friction. The contribution the summit conferences have made to this process appears to be relatively modest, though the spirit of partnership always displayed on these occasions should not be underestimated in the effect it can have on the political climate between the partner nations on either side of the Atlantic.

¹ Cocom = Coordinating Committee for East-West Trade Policy