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# European Update

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## US House Passes FSC Replacement Legislation; Anticipates Retaliation

*The European Update is produced by Anne Smith. If you have any questions or need more information, please contact Ms. Smith at 202.463.8493 or via e-mail at anne@moinc.com.*

In a move labeled by Treasury Deputy Secretary Stuart E. Eizenstat as "an extraordinary bipartisan, bicameral process", the US House of Representatives passed the 'FSC Repeal and Extraterritorial Income Exclusion Act Of 2000' on September 13 by a vote of 315 to 109.

Earlier this year, a WTO panel ruled that the US must modify a law permitting such companies as General Motors, Microsoft and Boeing to avoid payment of taxes on some overseas sales by channeling them through offshore subsidiaries.

Eizenstat continued by commenting that, "Enactment of this law is necessary to avoid an immediate confrontation with the EU, to ensure that the United States is in compliance with the WTO, and to avoid possible sanctions that would otherwise be imposed by the EU. This legislation would ensure that no US companies are disadvantaged."

The WTO panel contended that the FSC constituted an illegal export subsidy and raised two key objections to FSC legislation: a.) revenue that would normally be fully taxable under the Internal Revenue Code enjoyed a preferential rate of taxation thanks to FSC legislation and b.) the provisions allowed by FSC legislation constituted an illegal export subsidy because only exports were eligible for preferential tax treatment.

Under the WTO rules, Washington was given until October 1 to change the law,

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## Blair's Backing of Cashmere Stalls Carousel Sanctions

The long-awaited unveiling of European products subject to American "carousel sanctions" has been stalled by Britain's stringent objections to the inclusion of Scottish cashmere on the list of products targeted for retaliation.

The new European "hit list", which includes mostly foodstuffs and affects some $308 million in annual trade, could enter into effect on October 1 if the EU and the US fail to resolve the ongoing dispute over bananas and hormone-treated beef. The majority of products appearing on the list will be subject to 100% tariffs in the hopes of rendering them prohibitively expensive. However, the demand for some European luxury items such as truffles, mineral water and plastic Louis Vuitton handbags, even with prices doubled, continues to be so strong that officials will possibly hit them with 200% tariffs.

The thorn in the Clinton Administration's side is Scottish cashmere. UK Prime Minister Tony Blair has lobbied consistently for the exclusion of cashmere from the list. President Clinton, however, finds himself between a rock and a hard place. While he is loath to rock the boat with his close ally, Tony Blair, he must also answer to lawmakers from key US textile-producing states that have been pressuring the Administration for cashmere's inclusion.

To soften the blow, cashmere's inclusion

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## EU and Japan Pledge Enhanced Cooperation, New WTO Round

The EU-Japan Summit reached a positive conclusion as they pledged to strengthen ties and intensify efforts to start a new round of WTO talks this year. Yoshiro Mori, the Japanese Prime Minister, Romano Prodi, former president of the European Commission, and Jacques Chirac, current Commission President, made the commitment at a meeting in Tokyo just prior to the G-8 Summit in Okinawa . While the three leaders heralded the coming ten years as the "decade of Japan-Europe cooperation", little was accomplished in the way of substantive agreements, excepting cooperation in competition law.

During their last annual meeting on October 1999 in Tokyo, the Commission and the Japanese Fair Trade Commission concluded that it would be mutually beneficial to work towards strengthening their cooperation in the field of competition. The Community has shown increased interest in concluding several such agreements to reflect the increasing internationalization of the economy and the resulting impact within the Community.

The envisaged agreement on competition would facilitate the exchange of information on international competition cases and allow both parties to coordinate their competition investigations to the full extent of their respective domestic laws.

The principles projected for the future EU/Japan agreement are based on those outlined in bilateral agreements already established with the US and Canada. The cooperation between competition authorities is based on keeping in constant touch about relevant competition cases and by establishing arrangements for the exchange, use and protection of enforcement related information.

The two sides also pledged to strengthen ties and intensify efforts to start a new round of WTO talks this year. The pledge may ease EU concerns about Japan's conclusion of bilateral trade agreements with South Korea and Singapore that could potentially reduce Japanese commitment to the WTO. While emphasizing a broad berth for cooperation, however, the two sides did not make any firm commitments on timing for the new round, prompting critics to doubt that the Okinawa Summit will end in a concrete decision on the WTO.

## EU, China at Odds Over Compliance on Subsidies Disciplines, Bilateral Market Access

In a rare show of concerted action, the EU and the US are pushing China to accept full WTO disciplines on industrial subsidies. The rare partners are urging China to stop invoking provisions for developing countries that make it more difficult to file a successful challenge in the WTO. Intransigent, China continues to resist the demands and insists that it will not surrender rights accorded developing countries.

China's retention of developing status would render it very difficult to dispute subsidized Chinese exports in the markets of third countries that displace another WTO member's sales. Although China has already pledged not to use industrial export subsidies, the EU contends that these commitments must be enforceable in order to be meaningful and is now seeking more concessions from China in order to preserve effective remedies against subsidized industrial production in China. The EU has specifically pinpointed instances of Chinese use of underpriced inputs for industrial production as well as the practice of extending loans to enterprises on either non-commercial terms or on terms that do not require payment.

The EU and China are also at odds over aspects of their bilateral market access agreements and will continue negotiating to find acceptable middle ground. Among other issues, the parties have not yet agreed on how China will implement retail distribution rights and the Chinese granting of seven licenses to EU insurance companies. China has only issued two licenses for EU insurance companies, which forms a key part of their market access deal with the EU.

While much progress has been made in preparing for China's accession to the WTO, many issues continue to stump members of the working party. Of particular concern are transparency and licensing commitments in the services sector, the administration of tariff-rate quotas, commitments on agricultural export subsidies and domestic supports, technical barriers to trade, use of balance of payments measures, judicial review and general transparency issues.

### EU Investment in the US Undergoes Sharp Increase

Eurostat, the EU's statistical agency, found that flows of direct investment between the European Union and the US went sharply in favor of the US last year, offering in part an explanation for the Euro's weak performance on foreign exchange markets. According to Eurostat, business in the EU invested $151 billion in the US, an increase of roughly 25% over what they invested in 1998. In the other direction, US companies invested approximately $58 billion in the EU, an approximate 15% increase from 1998.

The data were heavily affected by figures for the UK, which is the EU's leader in foreign investment but is not a member of the eurozone.

## FSC Replacement Legislation, cont.'

prompting action in the Senate and House to determine an acceptable alternative to the FSC. The Clinton Administration's new legislation is already embattled by claims from the EU that it continues to violate the WTO as an export subsidy. The EU asserts its' illegality because it would tax domestic sales of an American products differently than it would income generated by imports.

The FSC Repeal and Extraterritorial Income Exclusion Act Of 2000' will do the following: a.) eliminate the FSC and b.) protect specified foreign income generated by exports originating in the US or by overseas sales of products made abroad by American-owned subsidiaries from American taxation. Such income would be subject uniquely to taxation abroad. The new system for offshore sales was approved by the House Ways and Means Committee in late July.

Eizenstat contends that the it was necessary to pass the legislation by October 1 in order to avoid intensifying the dispute with the EU, however it is suspected that a retaliation list is already in the works in anticipation of an unsatisfactory replacement to the FSC. Upon review of the new legislation, the EU is expected to demand a compliance review. If the US and the EU are unable to reach a compromise satisfactory to both parties, the EU is expected to request the WTO's permission to impose retaliatory sanctions on US exports.

The projected retaliation list is said to amount to $4 billion, which is ostensibly based on an estimate of the trade "damages" done by the FSC. In the case that the EU proposed a retaliation amount, that amount would be reviewed by a WTO arbitrator . If the proposed retaliation amount is accepted, it would represent a maximum amount, but would not necessarily constitute the EU's actions – they could choose either to impose partial retaliation or to seek compensation (trade concessions to the EU that would offset trade damage

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## Blair's Backing of Cashmere Stalls Carousel Sanctions, cont.'

was planned with the caveat that it would only appear in the case that the US and the EU failed to end the long-standing beef and banana war by November 15, 2000. However, the stubborn persistence of these disputes does not bode well for a rapid reconciliation, giving the British government little hope that cashmere will avoid retaliatory measures.

The current list was composed in hopes of stepping up pressure against the EU – rotating the products targeted done in hopes of spreading the fallout to more European industries, prompting them to pressure their governments to find a solution to the beef and banana wars. However, it seems that until a solution is found to the cashmere issue, the list will continue to live in limbo.

### Revised List of EU Exports Subject to Carousel Sanctions:

**New Entries:**
Sweet biscuits; waffles and wafers
Pecorino cheese
Paprika
Canned pears, peaches and mandarin oranges
Mineral Water

**Removed entries:**
Bath salts
Lithographs
Batteries
Chicory
Sausage casings
Fruit juices
Rusks

**On the Fence:**
Cashmere

**Reappearing Entries:**
Roquefort cheese
Louis Vuitton handbags
Frozen cow tongues, livers and brains

### Countries Commit to Revised Kyoto Convention

Switzerland, The Czech Republic, Morocco and New Zealand have signed the revised Kyoto Convention on the simplification and harmonization of customs procedures at ceremonies at the World Customs Organization in Brussels.

Unanimously adopted by the Council of the WCO in June last year, the revised Kyoto Convention established modern international standards in Customs procedures. Designed to enable more rapid clearance of goods, people and conveyances, the newly adopted procedures will maximize the use of new information technology and modern clearance techniques based on risk analysis.

Adding these requirements to their national legislation will allow nations to facilitate international trade, stimulate economic growth and provide targeted customs control at their borders. The revised Kyoto Convention will come into force when 40 members of the World Customs Organization – which today consists of 151 members – have signed. This brings to 12 the number of Members of the WCO who have signed the new Convention.

# Trade Briefs

## FSC Replacement Legislation, cont'.

caused by the FSC.) The dispute over the 'FSC Repeal and Extraterritorial Income Exclusion Act Of 2000' could not come at a worse moment, as Washington parries with Great Britain over cashmere and revises the list of European products to be targeted by the "carousel sanctions". The impending tariffs, amounting to more than $308.2 million, are retaliation for the EU's refusal to alter their restrictions on banana imports and hormone-treated beef.

## WTO Favors EU over US in wheat gluten dispute

On July 31, a WTO Panel contended that a US safeguard quota imposed on the import of wheat gluten violates WTO rules, specifically the WTO Agreement on Safeguards.

The US introduced the safeguard measure by imposing a quota on imports of wheat gluten from various sources, including from the EU, on 1 June 1998. As the main supplier of the product to the US (trade in 1997 amounted to US $41 million), the EU was severely affected by the measure which cut imports by 40%. The WTO stipulates that such a quota, if determined to be legal, must be equally applied to all third-country suppliers. However, the quota applied to the second exporter, Australia, was so generous that that it had to step up trade in order to fill the amount. Canada was also unjustifiably excluded from the safeguard measure.

The Commission expects the US to comply with WTO regulations and withdraw the measure. However, failure to do so will pave the way for the Commission to apply a compensatory tariff on the lucrative trade in corn gluten feed.

## Landmark EU-Mercosur Conference Set for October

On October 12, the European Commission will host a landmark conference on EU-Mercosur relations, providing an opportunity for stakeholders in the EU-Mercosur relationship to acquire first-hand information on trade negotiations and to facilitate and exchange of views.

The current EU-Mercosur relationship is based on the Interregional Framework Co-operation Agreement and aims for liberalization of all trade in goods and services in conformity with WTO rules, as well as an enhanced form of co-operation and a strengthened political dialogue. After three years of preparatory work the Heads of State and Government of the European Union and Mercosur at their summit meeting on 28 June 1999 in Rio de Janeiro formally decided to launch these negotiations.

The October conference follows the Mercosur EU Business forum and will prepare for the third round of negotiations which are scheduled to take place November 2000 in Brazil.

## US – EU Trade Disputes to Keep An Eye On….

As if US – EU trade relations needed any more bones of contention, hostilities over audio-visual products and funding for the development of Airbus' new super-jumbo jet, the A3XX, threaten to boil over.

Prompted by France, the EU has been maneuvering to control imports of American films and recorded music by Eastern European countries. Playing on these countries' desire to accede to the EU, their progress towards membership has at times depended on their imposition of higher import barriers against non-EU audio-visual material than those maintained by current EU member states. While the US government accepts current restrictions, USTR Charlene Barshefsky has made it clear that more stringent restrictions will be met with fierce opposition.

The flames of hostility have also been fanned over the funding of Airbus' A3XX. Large loans to companies in the Airbus consortium have been made by the British, French and German governments for the development of the aircraft, prompting Ms. Barshefsky to push for compliance with WTO stipulations on subsidies.

## South African Government Accuses EU of 'Sabotage'

The South African government contends that the EU has sabotaged the long-awaited wine and spirits agreement. Due to come into force on September 1, the accord resolved a bitter dispute over the labeling of spirits, which posed no small threat to the bilateral trade agreement. The agreement was finally reached with South Africa agreeing to phase out, within 12 years, the use of European names of origin, such as port and sherry. As a quid pro quo, the EU agreed to provide the South African wine industry with financial assistance.

However, the EU claims that a fresh host of technical details must be dealt with prior to the implementation, giving rise to frustration, resentment, and claims of sabotage by the South African Trade Ministry.