



# Committee On Finance

Max Baucus, Ranking Member

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**NEWS RELEASE**

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## **The United States and Europe: Trading Partners or Trading Adversaries? The New Atlantic Initiative**

Considered from a distance, the United States and Europe have every reason to maintain a stable, mutually supportive trading relationship.

The United States and the European Union have the largest trading relationship in the world. Each year, more than \$375 billion in goods and services cross the Atlantic. Historically, the trade has been relatively balanced, without the enormous trade deficits that weigh down U.S. trade with China and Japan.

Both the United States and Europe are rules-based societies, and both have led the way in establishing a rules-based global trading system. In fact, the United States and Europe are sometimes called the twin pillars on which the World Trade Organization is based.

Add to that strong cultural affinities and a history of working together to face some of the greatest challenges of the 20<sup>th</sup> century, and one might expect the United States and Europe to have a rock-solid trade relationship.

Unfortunately, this is not quite the case. In recent years, trade tensions have often flared to near crisis levels. Even seemingly minor disputes over meat from animals treated with growth hormones or trade in bananas have proven nearly insoluble.

Since 1995, the European Union has bombarded the United States with WTO challenges that go to the core of the U.S. trade and tax policy. At the same time, the EU has launched WTO complaints against the United States – like the challenge to the Byrd Amendment – that I believe are essentially nuisance litigation.

Making things worse, Europe has turned a deaf ear to a number of legitimate complaints raised by the United States.

## BIOTECH AND THE WTO

Many of the concerns the United States has raised against the EU center on one sector – agriculture.

The reason for decades of tension is obvious. In 1970, European Community was the largest net agricultural *importer* in the world. By 1980, thanks to Europe's Common Agricultural Policy or CAP, Europe had transformed itself into the world's largest net *exporter*.

As one of the world's major agricultural exporters, this shift cost U.S. farmers billions in lost exports and caused the cost of the farm program to sky rocket.

Europe's CAP continues to cost the U.S. billions in lost exports. But in recent years the United States has shifted its focus in part from dismantling the CAP to combating European programs, such as the hormone ban and the current moratorium on new biotech products that unfairly restrict U.S. exports.

The United States has, for some time, been contemplating bringing a formal WTO complaint against the ill-advised and unscientific moratorium on new farm products based on biotechnology. It is always difficult to foresee the future, but I think there is little doubt that a challenge to the EU moratorium would succeed in convincing a panel that it violates WTO rules.

But the United States has held back in deference to the EU's leaders who have argued that this issue is not appropriate for WTO litigation because it is widely supported by consumer groups in Europe. They make this claim without seriously addressing the fact that authorities in the United States and elsewhere have demonstrated these products to be safe. Indeed, these products have considerable potential to boost food production and provide consumers with a wider choice of affordable, healthy food.

I believe strongly that governments must make policy based upon *sound science*, not on fears based upon *science fiction*. But the EU continues to argue that the biotech moratorium is necessary – in spite of overwhelming scientific evidence – because of the fears of consumer groups. I personally do not know how much of this rhetoric is an honest explanation and how much is simply a convenient excuse for protectionism.

What's worse, the EU's irrational fears are becoming the basis for policy in other countries. It is time – in fact, well past time – for the United States to make a WTO complaint against Europe's irrational restrictions on farm product imports which have benefited from biotechnology.

I hope this point is heard not only in Europe, but in the decision making circles of the Bush Administration where the issue is presently stalled. To this point, the Administration has given too much weight to unrelated foreign policy concerns in making the decision on initiating a WTO complaint on this matter.

## **FSC-ETI TAX ISSUES**

I also find it comical that Europe's leaders argue that they cannot make agricultural trade policy based upon a U.S. complaint to the WTO, but feel perfectly justified in pressing the United States to reform its tax policies based upon their WTO complaint.

This brings me to the second major topic I wanted to focus on today, the trade dispute over Foreign Sales Corporation or FSC tax and its descendant, the Extraterritorial Income Exclusion.

My initial reaction to this dispute was that Europe was out of line in bringing the complaint. Nothing I have heard or seen since has led me to believe otherwise. Simply put, the FSC tax was no more trade distorting than Europe's practice of rebating its Value Added Tax on exports. Yet the EU pushed the case forward in direct contradiction of a two-decade old "gentleman's agreement" not to pick away at each other's tax policy.

The United States probably made a mistake by not ensuring that this "gentleman's agreement" was explicitly written into the WTO as Europe did when it won a grandfather clause for its VAT rebates. Nevertheless, the rationale for bringing this case – beyond tit-for-tat retaliation for U.S. action on bananas – escapes me.

Were I the U.S. Trade Representative, I would be inclined to counter Europe's tax challenge by vigorously defending our own policy, attacking the portions of the European tax system that are open to WTO challenge, and negotiating new rules on taxes that were fairer to the United States. This is why my colleagues and I included a principle negotiating objective in the 2002 Trade Act designed to seek just this kind of fairness.

Now, I recognize that I am not personally in charge of U.S. trade policy. But the Administration's reluctance to vigorously defend U.S. tax policy and demand fairness in WTO rules baffles me.

Nonetheless I have been working with my colleague Senator Grassley and others on considering a range of possible approaches to the FSC problem, including new legislation.

Over the last few months, my staff has analyzed a number of options in consultation with the Administration and others in Congress. I am now confident that it is possible to replace the FSC with a new manufacturing income exclusion, expanded research and development tax credit, or a combination of the two. And we need appropriate rules to transition to the new system.

Unlike some of the other legislative approaches that have been explored, I believe this approach would encourage companies that produce and export from the United States to continue doing so. That said, however, I do not believe that legislation like this should

be pursued in isolation. Rewriting U.S. tax policy is a wrenching and time-consuming exercise.

I would be much more confident in the process, if the Administration were meaningfully pursuing basic fairness in WTO rules on taxation. But right now, I see very little effort from the Administration to do its part. Instead, they seem to prefer that Congress shoulder the burden alone.

## CONCLUSION

As I said before, the fact that European leaders can argue that the WTO cannot be used as a forum to force change in European farm policy, while maintaining it is fine to attempt to use it to force changes in U.S. tax policy simply floors me.

In fact, the irony does not end with taxes. The United States is under WTO attack from Europe on many fronts. In addition to FSC, Europe is challenging the U.S. safeguard on steel imports, the Byrd amendment to redistribute dumping duties, current practice for deciding the impact of privatization on unfair subsidies and a raft of other issues.

In most of these cases, political gamesmanship seems to play at least as great a role as economic interest. It may surprise some in Europe, but I agree that some of the trade complaints pursued by the United States in the past may not have been chosen as carefully as they should have been.

That said, what is good for the goose is good for the gander. If Europe persists in this WTO litigation, the United States should employ all measures within its control to defend its policies and make sure the glare of the WTO also falls on some of Europe's many trade sins. There also may well be occasions in which the United States should persist in policies that particular WTO panels have criticized.

I do not, however, believe that this is the best way to do business. I believe that both Washington and Brussels could be more rational in deciding what issues to put before the WTO. I also believe that both would be better off resolving matters through serious consultations rather than relying on litigation.

Further, I still believe that more formal undertakings between the United States and Europe to expand trade and resolve disputes deserve consideration – perhaps even including the possibility of a real Trans-Atlantic Free Trade Area.

Unfortunately, if we cannot mutually manage far-sighted solutions, the United States must defend its trade interests. Washington, Brussels, and even the WTO must all be respectful of each other's legitimate prerogatives and interests. Otherwise, the road ahead may prove bumpy for all parties.