



# Executive Memorandum

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## HOW THE UNITED STATES AND THE EUROPEAN UNION CAN IMPROVE COOPERATION ON TRADE

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On March 9, the first meeting between U.S. Trade Representative (USTR) Robert Zoellick and European Trade Commissioner Pascal Lamy will take place in Washington. This encounter offers the United States and the European Union (EU) an opportunity to lay new groundwork for settling their trade disputes and improve cooperation on worldwide trade liberalization, particularly through the World Trade Organization (WTO). Both the United States and the EU have received favorable rulings from the WTO, sometimes at the other's expense, and this has led to the disputes that will likely headline the meeting. Both also have ignored the WTO's decisions when they proved unfavorable. As the world's largest trading partners, both sides should take a step back to consider the effects that these continuing disputes are having on their overall relations, trade liberalization, and the WTO itself.

**Resolving the Trade Disputes.** Each year, the United States imports \$195 billion from the European Union and exports \$151 billion in return. The ongoing disputes between the two over such issues as trade in bananas, genetically modified food, Airbus subsidies, and subsidies to foreign sales corporations have escalated rapidly over the past two years and, unless these trading partners can come to terms, could degenerate into a trade war. The impact of such a war would be large. If the volume of cross-Atlantic trade is significantly reduced, economic growth on both sides will suffer.

If the United States and the EU continue to bring

such disputes before the WTO and then disregard its rulings—as they have in the banana trade and anti-dumping cases, for example—the WTO's credibility as an international arbiter will decline, and its value as a mechanism for reducing trade barriers among its 140 member countries will be diminished. It is imperative that the WTO's economically strongest members abide by its rulings, however politically unpalatable they may be.

To resolve these disputes, Lamy and Zoellick should each recommit to abiding by WTO rulings. They should also each recognize the political sensitivities of these disputes and allow the other side sufficient time to arrive at a solution. Doing so would allow both the United States and the EU to honor their WTO commitments while increasing the ability of the institution to resolve trade disputes.

**Reducing Barriers to Trade.** At the March 9 meeting, the United States and the EU should also discuss how to achieve a new WTO round of multilateral trade negotiations. A successful new WTO round would lower trade barriers currently

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maintained by the 140 WTO member countries, which would lead in turn to increased worldwide economic growth. To increase the probability that a new WTO round will be successful, however, the United States and the EU must address the issues facing developing countries. In fact, one reason that the WTO meetings in Seattle in 1999 failed was precisely because the United States and the EU failed to grant improved market access to developing countries.

Both the United States and the EU have passed legislation meant to increase market access for developing countries. The EU recently proposed duty-free access to its market for 48 poor countries in the "Everything But Arms" plan. The United States enacted the Trade and Development Act of 2000 (P.L. 106-200) to increase access to the U.S. market for poor African and Caribbean countries. However, both of these initiatives offer only limited improvements in access to sectors that would help these developing countries the most—textiles and some agricultural goods in the U.S. market and sugar, rice, and bananas in the EU. Moreover, both efforts serve domestic protectionist interests far more than they promote economic development in poor countries. For example, under the EU's proposal, tariff reductions on rice and sugar would not even begin until 2006. Since 2006 is also the year in which the Common Agricultural Policy (CAP) is due for its next review, the likelihood that those tariffs will be eliminated or even reduced is slim.

Aside from denying market access to developing countries, the CAP is very costly to the EU and to the world economy. According to economists Brent Borrell and Lionel Hubbard, the total annual cost of the CAP to the world economy is around \$75 billion. Two-thirds of the cost (\$49 billion) is borne by Europeans in the form of higher prices, inefficient production, and economic distortions. The remainder—about \$25 billion, which is roughly equal to the total output of Ethiopia, Ghana, Uganda, and Zambia combined—falls on countries outside the EU in the form of lost agricultural export opportunities in Europe.

Similarly, the United States maintains barriers in the textile and apparel sector that impose enormous costs on U.S. citizens as well as on developing countries. Economists at the Institute for Interna-

tional Economics estimate that U.S. consumers would save up to \$24.4 billion, or approximately \$257 per household, if these barriers were eliminated. At the same time, according to Robert Feenstra of the University of California at Davis, the annual cost to foreign countries imposed by the continued maintenance of U.S. textile and apparel barriers ranges from \$4 billion to \$15.5 billion.

The European CAP and U.S. textile and apparel barriers are a significant burden on the world economy and clearly an impediment to trade liberalization. Zoellick and Lamy should begin to lay the groundwork for reforming the CAP and eliminating U.S. textile and apparel barriers. Both initiatives would be politically difficult, but by beginning the process, the United States and the EU would be sending a signal to developing countries that they are serious about trade liberalization. Furthermore, by giving greater market access to developing countries, the United States and the EU would benefit economically and would be increasing the probability that developing countries would agree to a new WTO round.

**Conclusion.** The United States and the European Union deserve praise for developing policies to reduce barriers to their markets, but unless tariffs are lowered and quotas abolished, the effectiveness of the Trade and Development Act and the Everything But Arms proposal will be limited. The United States and the EU have an excellent opportunity on March 9 to advance the cause of trade liberalization and lay the groundwork for resolving their bilateral trade disputes while increasing the probability of a successful new WTO round.

Clearly, trade liberalization is one issue upon which both sides should be able to act constructively. But both sides must realize that resolving their disputes will take time and that they should therefore begin the process immediately. This first meeting is the time to develop strategies for achieving mutually beneficial goals. The world will benefit from their example.

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