BEEF, BANANAS AND, NOW, FOREIGN SALES CORPORATIONS

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ABSTRACT

The United States (US) and the European Union (EU) are on the brink of another trade war that may make their dispute in the recent past over beef and bananas look like a minor skirmish. The new fight is over Foreign Sales Corporations (FSCs) of the US. The FSCs are a result of the Tax Reform Act 1984 enacted to encourage US companies to increase exports of US goods. Under the act, FSCs can save 15 to 30 per cent of federal income tax on their income from export sales. The EU claimed that FSCs are tax avoidance vehicles giving unfair tax advantage to US firms in their trade with EU and lodged a complaint with the World Trade Organization (WTO). WTO agreed with EU. On an appeal from US, WTO did not accept the American argument that FSCs receive act as illegal export subsidies to the US firms. Under the WTO ruling, the US has until October 1, 2000 to fix the problem and comply with the ruling or face severe sanctions.

INTRODUCTION

Alarmed by a huge trade deficit, in 1971 the Nixon administration concocted a special income tax break to United States (US) exporting companies that culminated in the creation of Foreign Sales Corporations (FSC). Under the FSCs, US exporters began enjoying hefty federal income tax savings. The FSCs never succeeded in reducing the trade deficit, a record $339 billion in 1999, but are now triggering the biggest trans-Atlantic trade war since the Boston Tea Party (Magnusson, 2000). The European Union (EU) lodged a complaint with the World Trade Organization (WTO) that the FSC tax breaks constitute an illegal trade subsidy. The WTO ruled in favor of the EU. In a final appeal by the US in 1999, the WTO Appellate Panel ruled that the FSC tax loophole violated the international trade laws prohibiting export subsidies. The US was given till October, 2000 to remove the FSC subsidies failure to comply with the WTO mandate can result in the US facing EU sanctions to the tune of $4 billion on US exports to the EU, the largest court ordered trade retaliation ever in history (Magnusson, 2000).

THE BANANA SPLIT

In fact, most Americans have never heard of the FSCs until recent rulings by the WTO. From the inception of the FSCs in 1984, many US trading partners in Europe have groused against the FSC provisions. But they tolerated it and deemed the problem as modest enough not worth starting a major trade dispute with the US. The EU firms feared that if they raised a stink over the FSCs, the US might try to bring the issue of the EU's Value Added Tax (VAT) and Border Tax Adjustments (BATs) which are EU rebates and import levies, on to the WTO table next round (Foster, 2000).

Then why this abrupt fracas about the FSCs, now? The real issue that triggered this trade war is not the FSCs. It stated with a dispute about bananas, with a touch of beef thrown in. As everyone knows, the US does not grow bananas. However, the well known banana firms, Chiquita and Dole are based in the US but produce almost all the bananas in Latin America. These firms have long complained that the EU import quotas discriminated by granting preferences to former French and British colonies in Africa, the Caribbean, and the Pacific (ACP) where EU based banana firms dominate the banana trade (Noland, 1999). EU imports of bananas from the ACP are almost totally accounted for by France which imports from Cameron and Ivory Coast, and by United Kingdom (UK) which imports from the Caribbean (McQueen, 1999). The EU policy which was in effect since 1993, waived all tariffs on bananas imported from their former colonies, giving those producers guaranteed quotas (White, 1999).

The US continuously supported the Latin American Allies and lodged complaints with the General Agreement of Tariffs and Trade (GATT) and later, with WTO against the European discrimination regarding the banana trade. The US won those cases repeatedly, in 1993, 1994, and 1997 (Noland, 1999). After repeated defeats, the EU stopped consultations with the US and Latin America countries and started claiming that it is in compliance of the WTO rulings without much change in its banana regime. The EU kept the US and Latin America in an endless loop of litigation, trying to put off US retaliation (Noland, 1999). Finally, in March 1999, US lost patience and prepared to impose sanctions on over $500 million of EU exports including Scottish cashmere, Italian pecorino cheese, and French linens among 17 different EU products. The WTO supported the US claims and for the time being the banana related sanctions against the EU remained in place (Barber, 1999).

WHAT IS THE BEEF?

Another burning issue, which has added fuel to the trade war fire between US and the EU, concerned with the transatlantic beef hormone wrangle. There is a long-standing Eu ban on importing US beef containing growth hormones treated cattle, without any scientific justification. In effect, the EU imposed a trade restriction based on production methods rather than on the product itself (Noland, 1999). The US contended that its loss due to the beef ban would amount to $900 million a year. The WTO found the EU in violation of trade polices and set deadlines to end the bans for both beef and bananas. The EU missed both the deadlines and the US retaliated with punitive tariffs. If the Eu continues with the bans, the US plans to expand the 1000% tariff to an additional 81 EU products, including Danish ham and cut flowers from the Netherlands (Oberndorf, 1999).

AND NOW, THE FSCs: THE SWEET REVENGE

Angry over repeated US legal victories before the WTO, the EU counter-attacked in 1998. They pounced upon a 1985 provision of the US tax code, the Foreign Sales Corporation (FSC) and claimed it an illegal subsidy. Thus, the transatlantic trade war has finally come to the FSCs. The historical background of the FSCs is as follows: By 1971, the US trade deficit amounted to a phenomenal $1.4

billion and the Nixon administration, in an effort to give boost to US exports, enacted the Domestic International Sales Corporation (DISC) provisions.

In 1984, European firms lodged complaints with the GATT, the precursor of the WTO. The GATT ruled that the export tax incentives granted to the DISCs were an illegal trade subsidy. In the same year, under the pressure from GATT, the US repealed the DISC provisions and enacted the Foreign Sales Corporations provisions which allowed hefty tax savings to big US exporters (Angus and Kies, 2000). Under the FSCs, the US allowed nearly 6000 US firms to set up off-shore export subsidiaries in Virgin Islands, Barbados, and Guam and exempted 15% to 30% of their earnings from US federal income taxes (Hess, 2000). The companies who owed some of these FSCs included major multinational corporations such as Boeing, Exxon, Mobil, Ford, General Motors, and Microsoft. The tax breaks gained by these companies through the FSC scheme amounted to nearly $4 billion a year (Cassidy, 2000).

The US and the EU have been at odds resulting in bitter fights over bananas and beef exports to the EU, in which the EU lost the legal battles repeatedly in the WTO hearings. In 1997, the EU, by way of retaliation, complained to the WTO that the FSCs provide US firms with illegal trade subsidies. The EU claimed that FSCs violated long standing trade rules under which goods sold for export can not be treated differently from goods sold on domestic markets. The US argued that the FSC legislation was based on trade rules adopted by the GATT in 1981 which held that member countries are not required to tax economic events that take place outside their territories. In October 1999, the WTO panel ruled that the US FSC provisions constituted a prohibited export subsidy under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). The panel mandated that the said subsidies be withdrawn by October 1, 2000 (Angus and Kies, 2000). The US appealed the decision and in February 2000. The Appellate body of the WTO upheld the WTO decision and ruled against the US (Franz, 2000).

On November 15, 2000, President Clinton signed into law, HR 4986, “the FSC Repeal and Extra-territorial Income Exclusion Act of 2000”, completing the process of responding to the WTO mandate. However, even under this new law, the US companies still enjoy considerable tax breaks. The new law replaces the FSC regime with special tax rates on earnings from export and non-export foreign sales by certain eligible manufacturers, irrespective of whether they are based in the US or overseas (Cassidy, 2000).

CONCLUSION

The new law enacted under the mandate of the WTO does not seem to end the prolonged trade war between the two warring parties, the US and the EU. The EU Trade Commissioner, Pascal Lamy already referred to the new provisions as, “Camouflage for the old system”, and claimed that it does not meet the basic WTO requirements. The EU has already announced its intention to impose retaliatory tariffs against US products to the tune of $4 billion. The EU initiated a challenge to the new legislation in the WTO. The US, in turn, has challenged the EU’s request to impose retaliatory tariffs. The two sides have agreed to work toward dispute resolution fully before the EU clamps sanctions unilaterally, next year. In spite of all the long-standing wrangling between the US and the EU, there is a continuing expansion in the US-EU trade. As Cassidy (2000) states, these trade disputes have not done much to slow down the transatlantic trade, which now total over $1 trillion, the largest two-way trade in the world.

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