Occasional squalls

WASHINGTON, DC

A ruling against America aggravates trade tensions

PASCAL LAMY, Europe's trade commissioner, and Bob Zoellick, his American counterpart, are famously good pals. Both have worked hard to improve a trade relationship that is often fractious. With some success: when George Bush visited Europe in mid-June, he pledged support, along with European leaders, for an "ambitious" new world trade round. Now, the bonhomie is about to be tested.

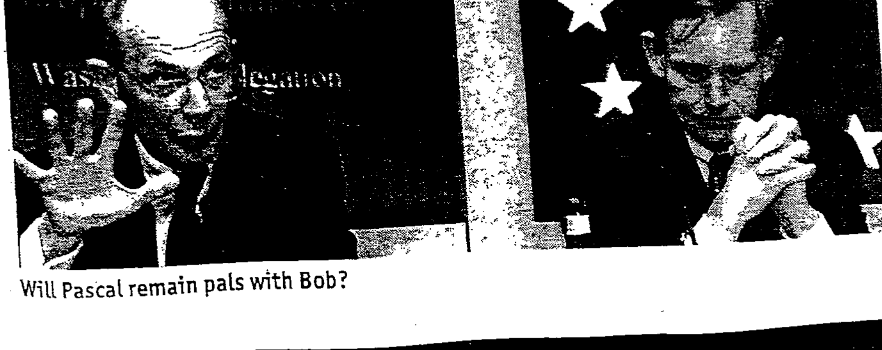
The latest challenge is an interim ruling by the World Trade Organisation on the legality of America granting income-tax breaks to exporters. Last year America changed the way it taxes exporters, in response to an initial ruling that its system broke WTO rules. Now the trade body has ruled against America again. A final decision will not be made public until August, but a leaked interim ruling suggests that America lost on nearly every point. If upheld on appeal, this would allow the European Union to impose up to $4 billion of punitive tariffs—ten times the tariffs imposed in the spats over beef and bananas.

No final decision is likely until after the November WTO summit at which a new global trade round is due to be launched. Also, the sheer scale of the potential trade war between America and the EU makes each party wary of firing the first shot.

Of the dozen-odd trade disputes between Washington and Brussels, all but one are European complaints at American behaviour, notably over steel. The Europeans are cross at American misuse of trade-protection instruments, such as anti-dumping and countervailing duties. On June 5th Mr Bush said he would help American steel by instigating a so-called "section 201" investigation, to the immense irritation of the Europeans.

Left to themselves, Mr Lamy and Mr Zoellick could probably sort out these spats. A less rational force is America's Congress, where suspicions of Europe are growing. The EU's opposition to the merger of GE and Honeywell, while not a trade issue, has raised hackles. Senator Fritz Hollings, chairman of the Senate Commerce Committee, fired off a letter to Mr Lamy this week, saying that a blocked merger would "undermine an already strained EU/US trade relationship".

Lawmakers will bridle at changing again the way America taxes exporters. A Senate insider says that, in retaliation, Congress may challenge European tax codes. More disputes over steel—which has powerful friends in Congress—would raise temperatures. Since the administration needs Congress to grant Mr Bush trade-promotion authority to negotiate a new trade round, Mr Zoellick's relationships with congressmen may be pitted against his friendship with Mr Lamy. ■



Will Pascal remain pals with Bob?

Wall Street

Of Aces and busted flushes

NEW YORK

Profits slump amongst investment banks

ALAN "ACE" GREENBERG chose his nickname to improve his chances with girls at the University of Missouri. But it is an apt encapsulation of his trading skills on Wall Street. This week, as the 73-year-old steps down as chairman of Bear Stearns, the investment bank where he has worked since 1949 is on a high. It recorded an increase in post-tax profits in the second quarter of 43% on a year earlier, at a time when many of its Wall Street rivals have stumbled. On June 26th Merrill Lynch issued a warning that its profits in the second quarter would fall by half, far short of expectations. Goldman Sachs and Morgan Stanley have also reported lower profits.

Strange that this surprised. Thanks to Alan Greenspan's frenetic cuts in interest rates, times are good for underwriters and traders of bonds, core activities for Bear Stearns and Lehman Brothers, which also recorded a sharp increase in profits. It has been a lousy time for equity underwriters and for advisers on the meagre amounts of mergers and acquisitions (M&A) this year. Merrill, Goldman and Morgan Stanley are three of the investment banks that gained most during the boom in equity and M&A business, and they are now suffering the most. Of the three, Merrill is weakest in bonds. It cut back its fixed-income activities after the collapse of Long-Term Capital Management (LTCM) in 1998. As it happens, both Bear Stearns and Lehman have long been criticised for their weakness in equities.

Mr Greenberg is famous for worrying about even the price of a paper-clip at Bear Stearns. This used to seem terribly unfashionable, but these days other Wall Street firms are obsessed about costs. Lay-offs are increasing, though not yet alarmingly—not least, because banks saw how Merrill Lynch lost ground when the markets rebounded quickly after the LTCM crisis. Still, if few signs of improvement show soon, expect real blood-letting on Wall Street.

Bank regulation

Basel postponed

Bank regulators get an extra year to complete a new regime

THE Basel committee of rich-country bank supervisors this week said it would take an extra year to prepare its ambitious new plans for bank capital. Relief? Yes. Surprise? No.

The new plans redraw the way the world's biggest banks would be supervised. At present, banks set a fixed ratio of capital against so-called risk assets. The proposals would allow the most sophisticated banks, if they passed muster, to use their own measures of risk to determine how much capital to set aside against both "credit" and "operational" risk.

Yet the plans to use banks' own risk-assessment models still look like a building-site. Overwhelming criticism from trade associations, banks, national regulators and others, filed before a deadline on May 31st, told the boffins of Basel that they needed to do a third draft, this time in closer cahoots with bankers.

The timetable for implementation now stretches to 2005. The hope is that this will be enough time for new consultative pa-

Charlemagne Pascal Lamy

The EU's trade commissioner with a finger on a nuclear button

THIS week's refusal by the European Union to countenance the merger of two giant American companies, Honeywell and General Electric, has already caused outrage in the United States (see page 62). But even before this new source of friction came between the world's two biggest trading blocks, a "nuclear device" was ticking below them, and Pascal Lamy, the EU's trade commissioner, has had his finger on the button. Lest this sound a touch melodramatic, be it said that the image is not Charlemagne's. It was Robert Zoellick, Mr Lamy's American opposite number and friend, who used it when discussing the possibility that the EU might impose billions of dollars of trade sanctions in its challenge to the United States' "foreign sales corporation" tax code, which it sees as a subsidy to American exporters.

Last month the EU won an interim ruling against the code at the World Trade Organisation. But getting it dismantled may prove tricky. Neither the Bush administration nor Congress is famed for tolerance of multilateral constraints on American freedom of action; the EU's decision to block the General Electric-Honeywell merger will hardly encourage them to comply with the WTO ruling. So the time may come when the EU could, in theory, slap up to $4 billion of sanctions on American exports. Since the case is still before the WTO, Mr Lamy will not discuss how itchy his finger may be. And, of course, the commission could not launch a war of mutually assured destruction—for such it would be—on its own: it would have to get Europe's political leaders behind it. But Mr Lamy's views will count.

The fact that he is a French Socialist will not reassure those in Washington who think the EU is spoiling for a fight. But Mr Lamy is no stereotypical American-bashing Frenchman. Keenly aware of American politics, he talks knowledgeably of the need to woo Congress and calls up a website to illustrate the exact progress of the confirmation hearings for George Bush's new appointees. In both work and leisure habits, he inclines more to American-style workaholism than to the 35-hour week that is now the law in his own country: the long hours he puts in are notorious, and his idea of relaxation is to run the New York marathon. Oh, and he speaks impeccable English.

Mr Lamy himself pointedly refrains from resorting to America-bashing. "I know the easiest way to get a cheer in Brussels is to stand up in the European Parliament and denounce America," he says, "but that's why you need telephone diplomacy, not megaphone diplomacy." He is proud that he and Mr Zoellick recently settled the long-running dispute over bananas. And, like the Americans, he sounds both keen and optimistic over the biggest trade question, whether this year will see the launch of a new round of world trade talks. But on one of the thorniest issues, agriculture, he is all European. Jacques Delors, the French former head of the European Commission, once remarked during a previous trade round that he would not sacrifice the French countryside on the altar of free trade. Mr Lamy, who was Mr Delors's chief of staff, stands firmly in this tradition.

Agriculture, he insists, cannot be seen as just another economic sector; it has a wider social significance. If European food prices were allowed to fall to world levels, he reckons that the EU would lose 5m of its 7m farmers. Alarmingly—given Japan's notorious protectionism—he sees strong affinities between European and Japanese attitudes to farming. Both cultures are concerned with food security, he says; both abhor a wilderness and believe that land is there to be cultivated. Of course, he agrees, agriculture will figure large in a new trade round. But, given his views, it is hard to foresee much progress on it.

Doing the splits

Mr Lamy's approach will disappoint free-traders. But it may still go too far for many in his natural political tribe, the French left. One of the loudest voices of the anti-globalisation movement is José Bové, a French farmer. Asked if he sympathises with Mr Bové, Mr Lamy—after a long pause—gives an anodyne reply: Mr Bové raises good questions but has the wrong answers.

The same desire simultaneously to keep faith with his political base and yet adapt to current realities colours Mr Lamy's approach to the subject that is his real passion, the future of the EU itself. As Mr Delors's former right-hand man, he is in an ambiguous and sensitive position. Many commission staff still hark back to the glory days of Mr Delors, when the commission drove forward European integration. Some French civil servants and politicians also deplore the way in which an "Anglo-Saxon emphasis on market economics has allegedly displaced grande political and social visions of Europe's future. Mr Lamy cannot endorse such criticisms openly, since to do so would be dangerously disloyal to his current boss, Romano Prodi, the hapless Italian head of the commission. Yet on occasions Mr Lamy will signal his unhappiness. He fiercely opposed a recent decision not to press for harmonisation of corporate-tax rates—somethi which the French prime minister, Lionel Jospin, has demande Mr Lamy is unrepentant in his opposition to the current commission line, insisting that "I definitely think fiscal competitio should not take place."

His critics in Brussels, and there are plenty, will take such statements as proof of their suspicion that, for all his talk of Eu rope, Mr Lamy is ultimately a French nationalist, pushing a di tinctly Gallic—more precisely, Gaullist—view of Europe's futu Maybe. But then commissioners in Brussels who happen to b British or German also often promote ideas that reflect their n tional prejudices. And when it comes to wearing his trade ha Mr Lamy's background on the French left may even prove an vantage. Just as it used to be said that only a right-wing Repu can like Richard Nixon could reconcile the United States with China, so it may take a French Socialist to reconcile Europe to new round of trade liberalisation. ■