

Issue Brief for Congress

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U.S.- European Union Trade Relations: Issues and Policy Challenges

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U.S.-European Union Trade Relations: Issues and Policy Challenges

SUMMARY

The United States and European Union (EU) share a huge and mutually beneficial economic partnership. Not only is the U.S.-EU trade and investment relationship the largest in the world, it is arguably the most important. Agreement between the two economic superpowers has been critical to making the world trading system more open and efficient.

Given a huge level of commercial interactions, trade tensions and disputes are not unexpected. While trade tensions in the past have tended to ebb and flow, some observers believe that this year's threat of a trade war is more serious than before. A dispute over steel trade is the proximate cause of rising trade tensions, but other high-profile disputes involving tax breaks for U.S. exporters and the treatment of genetically-engineered (GE) products lurk in the background.

Resolution of U.S.-EU disputes has become increasingly difficult in recent years. Part of the problem may be due to the fact that the U.S. and the EU are of roughly equal economic strength and neither side has the ability to impose concessions on the other. Another factor may be that many bilateral disputes now involve clashes in domestic values, priorities, and regulatory systems where the international rules of the road are inadequate to provide a basis for effective and timely dispute resolution.

In order to build a smoother relationship, Brussels and Washington may have to resolve a number of these disputes and avoid an outbreak retaliatory actions this year. The agreement to launch a new round of multilateral trade negotiations at the WTO trade ministerial held last November in Doha, Qatar

has facilitated this effort. But the recent passage of U.S. legislation increasing farm spending could complicate efforts to move the Doha Round forward and thwart the new round's potential beneficial impact on resolving other disputes.

The two sides now must deal with the fall-out from the Bush Administration's March 5, 2002 decision to impose temporary tariffs of up to 30% on approximately \$8 billion in steel imports. Reacting angrily to this action, the EU on March 27, 2002 announced provisional tariffs of its own on steel. More provocatively, the EU took initial steps under an untested provision of the WTO to impose retaliatory tariffs on U.S. exports without an explicit authorization to act. If Brussels pursues this course, U.S. -EU trade tensions are likely to escalate and potentially more explosive disputes involving the U.S. foreign sales corporation tax benefit for exports and the EU's policy towards approval of new GE products could become more difficult to manage.

The major U.S.-EU trade and investment policy challenges can be grouped into six categories: (1) avoiding a "big ticket" trade dispute associated with steel or the tax breaks for U.S. exporters; (2) resolving longstanding trade disputes involving Airbus production subsidies and beef hormones; (3) dealing with different public concerns over new technologies and new industries (4) fostering a receptive climate for mergers and acquisitions; (5) strengthening the multilateral trading system; and (6) reaching understandings on foreign policy sanctions that have a trade impact.



MOST RECENT DEVELOPMENTS

House Ways and Means Committee Chairman Bill Thomas introduced on July 11, 2002 international tax reform legislation (H.R. 5905) to bring U.S. tax law into compliance with the World Trade Organization.

European Parliament deputies voted on July 3, 2002 in favor of a virtual ban on the presence of genetically modified material not authorized in the European Union food and animal feed, while imposing strict traceability and labeling requirements on genetically-engineered foods.

EU Trade Commissioner Pascal Lamy stated on June 21, 2002 that he remains reluctant to impose trade sanctions in the ongoing U.S.-EU disputes over steel and tax breaks for U.S. exporters.

The European Union and Japan on May 15, 2002 notified the World Trade Organization of their intent to retaliate against U.S. steel safeguard tariffs if the United States does not provide concessions either in the form of compensation or steel exclusions.

The European Commission on April 19, 2002 proposed to EU member states a list of U.S. exports, ranging from fruits and rice to steel and apparel products, that would be subject to an additional 100% tariff in retaliation for a steel safeguard imposed by the Bush Administration in March.

A senior European Union official stated the Commission intends to begin a process of progressively approving biotechnology products beginning on October 17, 2002.

U.S. Trade Representative Robert Zoellick stated on February 7, 2002 that the United States is considering filing a formal complaint against the EU in the WTO over its moratorium on imports of genetically modified organisms (GMOs).

The World Trade Organization's highest appeals body on January 14, 2002 made a final judgment that the U.S. Foreign Sales Corporation Replacement and Extraterritorial Income Exclusion Act is an illegal export subsidy. Barring a negotiated settlement, the EU will be free to impose retaliatory duties on U.S. exports possibly in the range of \$4 billion. The amount of the retaliatory duties that can be imposed will be determined by a WTO arbitrator, with a decision due in August 2002.

BACKGROUND AND ANALYSIS

Overview

The United States and the European Union (EU) share a huge and mutually beneficial economic partnership. Not only is the U.S.-EU trade and investment relationship the largest in the world, but it is also arguably the most important. Agreement between the two partners in the past has been critical to making the world trading system more open and efficient.

Given the high level of U.S.-EU commercial interactions, trade tensions and disputes are not unexpected. While trade tensions in the past have tended to ebb and flow, some observers believe that this year's threat of a trade war is more serious than before. A dispute over steel trade is the proximate cause of rising trade tensions, but other high-profile disputes involving tax breaks for U.S. exporters and the treatment of genetically-engineered (GE) products lurk in the background.

The two sides face a major challenge this year in avoiding an outbreak of tit-for-tat retaliation. While the agreement reached to launch a new round of multilateral trade negotiations at last November's WTO trade ministerial in Doha, Qatar provides a basis for building a smoother relationship, the 2002 U.S. farm bill may complicate continuing U.S.-EU cooperation on this front. Congress in its response to both EU practices and Bush Administration initiatives will play a key role in managing the U.S.-EU economic relationship.

Closer Economic Ties

The United States and the European Union share the largest bilateral trade and investment relationship in the world. Annual two-way flows of goods, services, and foreign investment transactions exceeded \$1.1 trillion in 2000. Viewed in terms of goods and services, the United States and EU are each other's largest trading partners. Each purchases about one-fifth of the other's exports of goods and about one-third of the other's exports of services. And much of the trade in goods is increasingly in high-technology and sophisticated product areas where incomes and tastes are the primary determinants of market success.

Based on a population of some 377 million citizens and a gross domestic product of about \$7.8 trillion (compared to a U.S. population of 284 million and a GDP of \$9.9 trillion) in 2000, the fifteen members of the EU provide the single largest market in the world. Given the reforms entailed in the introduction of the European single market in the early 1990s, along with the introduction of a single currency, the euro, for twelve members, the EU market is also increasingly open and standardized. Over the next decade, with a possible enlargement to 27 countries, the EU market could become even more important as a destination for U.S. exports and investments.

The fact that each side has a huge investment position in the other's market may be the most significant aspect of the relationship. By year-end 2000, the total stock of two-way direct investment reached \$1.37 trillion (composed of \$802 billion in EU investment in the United States and \$573 billion in U.S. investment in the EU), making U.S. and European companies the largest investors in each other's market. This massive amount of ownership of companies in each other's market translates into an estimated 3.5 million Americans who are employed by European companies and an equal number of EU citizens who work for American companies in Europe.

Growing Strains

Given the huge volume of commercial interactions, it is commonly pointed out that trade disputes are quite natural and perhaps inevitable. While the vast majority of two-way trade and investment is unaffected by disputes, a small fraction (often estimated at 1%-2%)

of the total often gives rise to controversy and litigation. Historically, with the possible exception of agriculture, the disputes have been handled without excessive political rancor.

Over the past several years, however, trade relations are being strained by the nature and significance of the disputes. The EU Commissioner for Trade, Pascal Lamy, stated on November 20, 2000 that the “problems seem to get worse, not better.” Richard Morningstar, then U.S. Ambassador to the EU, said in a January 23, 2001 speech that the inability of our two sides “to resolve our list of disputes, which are growing in both number and severity, is beginning to overshadow the rest of the relationship.” Moreover, some of the efforts at dispute resolution have led to escalation and “tit-for-tat” retaliation with the potential to harm the multilateral trading system.

In 1999 the United States imposed punitive tariffs on \$308 million of EU exports of mostly higher value-added agricultural products such as Danish ham and Roquefort cheese. This action was a response to a refusal by the EU to change its import regimes for bananas and hormone-treated beef which the World Trade Organization (WTO) determined to be in violation of world trade rules. EU pique over U.S. pressures on bananas and beef, in turn, led the EU to threaten retaliation against \$4 billion dollars in U.S. exports that the WTO found in violation of an export subsidy agreement. In addition, the EU has filed numerous WTO dispute resolution petitions alleging that a variety of U.S. trade laws violate international obligations in some technical fashion, contributing to an impression that these challenges are part of a concerted EU strategy to weaken or gut U.S. trade laws.

The underlying causes of the trade disputes are varied. Some conflicts stem primarily from traditional demands from producer or vested interests for protection or state aids. Other conflicts arise when the United States or the EU initiate actions or measures to protect or promote their political and economic interests, often in the absence of significant private sector pressures. Still other conflicts are rooted in an array of regulations that deal mostly with issues that are considered domestic policy.

Resolution of these disputes has proven difficult in recent years. Part of the problem may rest in the fact that the EU and United States are of roughly equal economic strength and neither side has the ability to impose concessions on the other. Another factor may be that numerous new disputes involve clashes in domestic values and priorities where the international rules of the road are inadequate to provide a basis for effective and timely dispute resolution. (For further discussion, see CRS Report RL30732, *Trade Conflict and the U.S.-European Union Economic Relationship*.)

Current Trade Agenda

The United States and European Union have a full plate of high profile bilateral disputes this year. Several of the disputes may need to be resolved and new potential disputes avoided if the bilateral trade strains are to be contained and a smoother trade relationship is to develop. Moreover, progress on the bilateral front could provide a foundation for the two trading giants to make progress in efforts to begin the process of multilateral trade negotiations as prescribed by the Doha Ministerial Declaration.

Resolution of disputes over steel and the FSC are at the top of the list of bilateral challenges. President Bush’s March 5, 2002 decision to provide protective tariffs to the U.S.

steel industry for a three year period was widely criticized in Europe, and prompted a quick response. On March 27, 2002, citing a threat of diversion of steel from the U.S. market to Europe, the EU announced provisional tariffs of 15% to 26% on 15 different steel products. More provocatively, the EU took initial steps under an untested provision of the WTO to impose retaliatory tariffs on U. S. exports without explicit authorization to act.

If Brussels decides on swift retaliation rather than waits until 2003 for the WTO to rule on whether the U.S. steel tariffs are a violation of world trade rules, U.S. trade officials will be under great pressure to retaliate against the retaliation. In this context, U.S.-EU trade tensions could spillover and affect potentially more explosive disputes involving the FSC tax benefits for U.S. exports and the EU's policy towards approval of new GE products.

Major Issues and Policy Challenges

Major EU -U.S. trade and investment issues and policy challenges can be grouped into six different categories: (1) avoiding a “big ticket” trade dispute; (2) resolving two longstanding trade disputes; (3) dealing with disputes involving new technologies or industries; (4) fostering a receptive climate for mergers and acquisitions; (5) strengthening the multilateral trading system; and (6) accommodating trade-related foreign policy sanctions. A summary and status update of each challenge follows.

Avoiding A “Big Ticket” Trade Dispute

Perhaps the most serious trade disputes that currently cloud the bilateral relationship deal with steel and tax breaks for U.S. exporters. If not managed properly, either could lead to a massive disruption of trade and a major increase in political tensions.

Steel Trade.¹ Conflict over steel is again a high priority issue. Although the EU industry has undergone significant consolidation and privatization in recent years, the U.S. government alleges that many EU companies still benefit from earlier state subsidies and/or engage in dumping steel products (selling at “less than fair value”) in foreign markets. U.S. steel companies have aggressively used U.S. trade laws to fight against EU steel imports by filing antidumping and countervailing duty petitions that include imports from EU countries. In return, the EU has countered with five recent challenges in the WTO against the alleged U.S. misuse of its countervailing duty and antidumping laws. Moreover, the EU, along with eight other petitioning countries, initiated on July 10, 2001 a WTO dispute resolution complaint against the so-called “Byrd” law, which allows duties collected under the U.S. antidumping and countervailing duty statutes to be returned to the injured U.S. industry. The law was passed with major backing of the U.S. steel industry.

In addition to “unfair” trade disputes, President Bush announced June 5, 2001 that his Administration would call upon the U.S. International Trade Commission (ITC) to begin an investigation on international trade in steel under Section 201 of U.S. trade law. He also announced that he would seek multilateral negotiations with U.S. trading partners on fundamental issues of global overcapacity and government subsidies. The President was

¹ Prepared by Stephen Cooney, Industry Analyst, Resources, Science, and Industry Division.

reacting to continued problems in the U.S. steel industry, parts of which still have not recovered from a major import surge in 1997-98. The rise in imports to more than a quarter of U.S. finished steel consumption was stimulated by financial crises in Asia, Latin America and Russia, which reduced demand in those markets, and by the dramatically lower dollar-equivalent prices for many foreign producers. After a partial recovery in 1999-2000, the U.S. industry has again been affected by imports rising to more than 20% of finished steel consumption, record-high levels of semi-finished products and falling market demand and prices.

Section 201 relief, often referred to as “safeguard,” provides for temporary restrictions on imports that have surged in such quantities as to cause or threaten to cause serious injury to a domestic industry. The procedure is compatible with the rules of the World Trade Organization (WTO). A Section 201 case does not in itself need to demonstrate dumping, subsidization or other unfair practices by U.S. trading partners.

The ITC in October determined that U.S. producers of about 80% of U.S.-made steel are being injured by imports. The decision does not automatically mean that quotas or duties will be imposed on the products found to be causing the injury. The decision is left to the President, following recommendations from ITC on what remedy to impose.

On March 5, 2002, President Bush announced trade remedies for all products on which the ITC had found substantial injury except two speciality categories. All remedies or import restrictions will be for a three-year period beginning on March 20, 2002. The tariffs will be up to 30% on approximately \$8 billion in steel imports. Canada, Mexico, and other U.S. free trade partners were exempted from all tariffs.

The U.S. decision raised cries of indignation and protectionism from European leaders, and prompted a quick response. On March 27, 2002, citing a threat of diversion of steel from the U.S. market to Europe, the EU announced provisional tariffs of 15% to 26% on 15 different steel categories. More provocatively, the EU took initial steps under an untested provision of the WTO safeguards agreement to impose retaliatory tariffs by as early as June 18, 2002 on U.S. exports without an explicit authorization to act.

Subsequently, the EU foreign ministers agreed to a plan that entailed notification to the WTO by June 18 of a list of approximately \$360 million worth of U.S. exports targeted for sanctions. At the same time, the EU proposed not implementing those sanctions until early August or mid-October of this year in order to give the United States time to propose EU steel products that will be exempt from the safeguard measures as well as agree on a compensation package of reduced tariffs that would make up for the rest of lost steel imports. The European Commission is scheduled to report on July 19, 2002 on whether the tariff exclusions so far provided to European steelmakers are sufficient compensation for the tariffs and whether they provide sufficient justification to postpone retaliation until mid-October. If not, the decision to retaliate could be made in early August.

If Brussels decides on swift retaliation rather than waits until 2003 for the WTO to rule on whether the U.S. steel tariffs are a violation of world trade rules, U.S. trade officials will be under great pressure to counter-retaliate. In this context, U.S.-EU trade tensions are likely to escalate and potentially more explosive disputes involving the tax benefit for U.S. exports and the EU's policy towards approval of ne GE products could become more difficult to

manage. (For more discussion, see CRS Electronic Briefing Book on Trade, [<http://www.congress.gov/brbk/html/ebtra1.shtml>], *Steel: Trade and Industry Issues*.)

U.S. Tax Benefits for Exports.² The controversy between the European Union (EU) and the United States over U.S. tax benefits for exports has been simmering for years. Since 1984, the U.S. tax code provided an export tax benefit known as the Foreign Sales Corporation (FSC) provisions, which enabled U.S. exporters to exempt between 15% and 30% of their export income from U.S. tax. According to Internal Revenue Service data, FSC was used in connection with almost half of U.S. annual exports of goods. In 1998, however, the EU lodged a complaint with the World Trade Organization (WTO), arguing that the United States' FSC tax benefit was an export subsidy and was, therefore, in violation of the WTO agreements.

An aspect of the controversy concerns why the EU waited almost 14 years to challenge the U.S. tax provision. While EU officials maintain they never formally agreed that the FSC was legal, many on the U.S. side suspect that the challenge had much to do with EU pique over U.S. challenges in the WTO to the EU's import regimes for beef and bananas. Winning a case that involved a large amount of trade may also have been seen by some Europeans as providing significant negotiating leverage that could be used to settle other trade disputes as well. The EU responded that the challenge was prompted by an effort to level the playing field, but there is little indication that European companies, with the possible exception of Airbus, were proponents of the challenge.

In October 1999, a WTO panel issued a report that essentially upheld the EU's position. An appeal by the United States was denied, and, under WTO procedures, the United States had until October 2000, to bring its tax system into WTO-compliance or face possible retaliatory measures by the EU.

In November 2000, the United States repealed the FSC and put in its place the "extraterritorial income (ETI)" regime. The ETI provisions consist of a tax benefit for exports of the same magnitude as FSC, but also extend tax free treatment to a certain amount of income from exporters' foreign operations. The partial tax exemption for extraterritorial income is the design feature of the ETI provisions that is intended to achieve WTO compliance. However the EU maintains that the ETI provisions provide an export subsidy in the same manner as FSC, and has asked the WTO to rule against it. The EU also requested the authority to impose \$4 billion in retaliatory duties on U.S. goods, an amount 12 times greater than the \$300 million in punitive duties the U.S. imposed in the beef and banana cases.

An interim WTO report, which was delivered to the United States and EU on June 22, 2000, indicated that the new law continues to provide export subsidies and also that it provides less favorable treatment to imported products than that accorded U.S. made products. U.S. Trade Representative Robert Zoellick called the report a "nuclear bomb."

² Prepared by David Brumbaugh, Specialist in Public Finance, and Jane G. Gravelle, Senior Specialist in Economic Policy, Government and Finance Division

The Bush Administration opted to appeal the WTO ruling. But the appeal was rejected by the WTO on January 14, 2002, thereby leaving both sides with difficult choices. The options for a settlement include U.S. efforts to enact further changes in its tax laws to conform to WTO rules; U.S. offers of compensation to the EU for trade damages; or U.S. acceptance of EU trade retaliation.

Currently, the Bush Administration and Congress are exploring the legislative option and EU officials have vowed to allow the U.S. time to make the necessary changes as long as there is a clear indication that progress is being made. Specifically, the introduction on July 11, 2002 of tax reform legislation (H.R. 5905) aimed at bringing the U.S. tax law into conformity with WTO obligations may serve as the kind of ‘progress’ towards compliance that the EU has been demanding for retaliation to be held in abeyance. But the European Commission has prepared a draft list of U.S. exports that could be targeted for retaliation in the event that the tacit agreement between Washington and Brussels on the process for changing the U.S. tax provision in dispute breaks down.

In the interim, a WTO arbitration panel is scheduled to set the level of trade damages by late July 2002. The U.S. has argued that the EU may have the right to impose \$1.05 billion to \$1.11 billion in annual punitive duties but the EU has argued that the trade damages amount to \$4.04 billion. Once the WTO sets the level of retaliation, the EU is free to seek the authorization to retaliate against the United States, but it now appears less likely that the EU would actually implement retaliation measures. (For further discussion, see CRS Report RS20746, *Export Tax Benefits and the WTO*).

Resolving Longstanding Disputes

The United States and EU are engaged in long-running disputes involving aerospace production subsidies and trade in beef that has been treated with hormones. While neither of these disputes are currently on the front-burner, some efforts at resolution are likely to continue this year.

Airbus Production Subsidies³

On December 19, 2000, Airbus announced that it had formally launched a program to construct the world’s largest commercial passenger aircraft, the newly numbered Airbus A380. In the spring of 2001, Boeing dropped its support of a competing new large aircraft, opting instead to focus on the development of a new class of higher speed commercial aircraft. The Airbus action potentially reopens a long-standing trade dispute between the United States and Europe about subsidization of aircraft projects that compete directly with non-subsidized U.S. products, in this case the Boeing 747 series aircraft.

The large commercial aircraft (jet aircraft with 100 or more seats) production industry is essentially a duopoly consisting of an American manufacturer, Boeing, and a European manufacturer, Airbus. Until recently Airbus was a consortium of national aviation firms, some with close government ties, who cooperated to produce commercial aircraft. As a

³ Prepared by John W. Fischer, Specialist in Transportation, Resources, Science, and Industry Division.

result of recent European aerospace industry consolidation, Airbus is now owned by just two firms, EADS and BAE systems. Airbus itself is reforming as a public firm under the name Airbus Integrated Company. In recent years, after two decades of trying, Airbus has come close to achieving parity in sales with Boeing.

The basic premise of the dispute between the U.S. and EU is whether, as U.S. trade policymakers contend, Airbus is a successful participant in the market for large commercial jet aircraft not because it makes competitive products, which by all standards it does, but because it has received significant amounts of governmental subsidy and other assistance, without which it probably would not have been able to enter and participate in the market. The assistance from the governments of France, Germany, Spain and Great Britain arguably has included equity infusions, debt forgiveness, debt rollovers and marketing assistance, including political and economic pressure on purchasing governments. Airbus, not surprisingly, does not accept the U.S. view of the reasons for its success.

At issue in the A380 development is at least \$3.1 billion in already identified direct loans to be provided by seven of the nine EU Member State governments in the A380 development. The total cost is estimated to be \$12 billion. The United States is concerned that the level of state-aid needed for this project could violate Member States' adherence to their bilateral and multilateral obligations, including the WTO Agreement on Subsidies and Countervailing Measures (SCM). The United States has urged the Airbus member governments to ensure that the terms and conditions of their support for the A380 are consistent with commercial terms and rates and with their international obligations.

To date, the Bush Administration has not changed U.S. policy on this issue. At a June 6, 2001 meeting of the WTO Committee on Civil Aircraft, Bush Administration officials pressed the EU for more information on the financing of the A380. The EU responded with the provision of mostly general information about the scope and nature of their member states' support for the A380. The United States is still seeking more detailed information, including information on the critical project appraisal - Airbus' projections on costs and sales of the A380. In response, the EU raised questions concerning alleged subsidies Boeing receives from the U.S. government and its dealings with the Department of Defense. (For further discussion, see CRS Electronic Briefing Book on Trade, [<http://www.congress.gov/brbk/html/ebtra1.shtml>], *Airbus and Competition Issues*).

Beef Hormones. The dispute over the EU ban, implemented in 1989, on the production and importation of meat treated with growth-promoting hormones is one of the most bitter disputes between the United States and Europe. It is also a dispute, that on its surface, involves a relatively small amount of trade. The ban affected an estimated \$100-\$200 million in lost U.S. exports -less than one-tenth of one percent of U.S. exports to the EU in 1999.

The EU justified the ban to protect the health and safety of consumers, but several WTO dispute settlement panels subsequently ruled that the ban was inconsistent with the Uruguay Round Sanitary and Phytosanitary (SPS) Agreement. The SPS Agreement provides criteria that have to be met when a country imposes food safety import regulations more stringent than those agreed upon in international standards. These include a scientific assessment that the hormones pose a health risk, along with a risk assessment. Although the WTO panels concluded that the EU ban lacked a scientific justification, the EU refused to

remove the ban primarily out of concern that European consumers were opposed to having this kind of meat in the marketplace.

In lieu of lifting the ban, the EU in 1999 offered the United States compensation in the form of an expanded quota for hormone-free beef. The U.S. government, backed by most of the U.S. beef industry, opposed compensation on the grounds that exports of hormone-free meat would not be large enough to compensate for losses of hormone-treated exports. This led the way for the United States to impose 100% retaliatory tariffs on \$116 million of EU agricultural products from mostly France, Germany, Italy, and Denmark, countries deemed the biggest supporters of the ban.

The U.S. hard line is buttressed by concerns that other countries might adopt similar measures based on health concerns that lack a legitimate scientific basis according to U.S. standards. Other U.S. interest groups are concerned that non-compliance by the EU undermines the future ability of the WTO to resolve disputes involving the use of SPS measures.

Recent occurrences of “mad cow disease” in several EU countries and the outbreak of foot-and-mouth disease (FMD) in the United Kingdom and three other EU countries have contributed to an environment that is not conducive to resolving the meat hormone dispute. The EU has recently indicated its intention to make the ban on hormone-treated meat permanent, while at the same time expressing some openness to renewing discussions about a compensation arrangement which would increase the EU’s market access for non-hormone treated beef from the United States. In discussions held June 11, 2001, a U.S. industry proposal for expanded access to the EU market for hormone-free beef for a period of 12 years was rejected by the EU. In response, the EU countered with a 4-5 year period for compensation. The compensation talks have since languished. But a February 20, 2002 EU Standing Veterinary Committee proposal to repeal the requirement that 20% of beef imported from the U.S. be tested for the presence of hormones could remove an important obstacle in the compensation talks by making it easier for U.S. non-hormone beef producers to take advantage of any improved market access conditions.

In pursuing compensation talks, the Bush Administration is faced with a divided industry position. The American Meat Institute and the American Farm Bureau prefer carousel retaliation to settle the dispute while the American Cattlemen’s Beef Association supports efforts to gain increased access for non-hormone treated beef in exchange for dropping the retaliatory tariff on EU exports. Thus far, EU offers of compensation for lost U.S. meat exports in lieu of lifting the ban have been rejected by the United States.

The Bush Administration has maintained that it would not use so-called “carousel” retaliation (rotating the products subject to retaliation) while the negotiations for compensation are on-going. Some observers speculate that both the EU and the U.S. have made a political decision to handle the dispute by insisting that they are making progress toward a resolution. This arguably could shield USTR from congressional and private sector pressures to apply the carousel provision against the EU.

Resolution of the dispute could remove a critical irritant to the overall U.S.-EU trade relationship. How it is resolved could also have important implications for future WTO

disputes involving the use of SPS measures to restrict trade. (For further discussion, see CRS Report RS20142, *The European Union's Ban on Hormone-Treated Meat.*)

Dealing with Different Public Concerns Over New Technologies and New Industries

The emergence of new technologies and new industries is at the heart of a growing number of disputes. Biotechnology as a new technology and e-commerce (and related data privacy concerns) as a new industry are emerging issues that have great potential for generating increases in transatlantic welfare, as well as conflict. These issues tend to be quite politically sensitive because they affect consumer attitudes, as well as regulatory regimes.

Bio-technology.⁴ Differences between the United States and the EU over genetically engineered (GE) crops and food products that contain them pose a potential threat to, and in some cases have already disrupted, U.S. agricultural trade. Underlying the conflicts are pronounced differences between the United States and EU about GE products and their potential health and environmental effects.

Widespread farmer adoption of bio-engineered crops in the United States makes consumer acceptance of GE crops and foods at home and abroad critical to producers, processors, and exporters. U.S. farmers use GE crops because they can reduce input costs or make field work more flexible. Supporters of GE crops maintain that the technology also holds promise for enhancing agricultural productivity and improving nutrition in developing countries. U.S. consumers, with some exceptions, have been generally accepting of the health and safety of GE foods and willing to put their trust in a credible regulatory process.

In contrast, EU consumers, environmentalists, and some scientists maintain that the long-term effects of GE foods on health and the environment are unknown and not scientifically established. By and large, Europeans are more risk averse to the human health and safety issues associated with bio-engineered food products than U.S. citizens.

In 1999 the EU instituted a *de facto* moratorium on any new approval of GE products. The moratorium has halted some \$300 million in U.S. corn shipments. EU policymakers also moved toward establishing mandatory labeling requirements for products containing GE ingredients. Subsequently, the EU has put in place legislation to restart the process of approving GE crop varieties, but has yet to complete regulations on labeling GE foods. On July 25, 2001, the European Commission proposed stringent rules on labeling and traceability of GM food and animal feed. U.S. biotechnology, food, and agriculture interests are concerned that these regulations, if adopted by the EU governments and EU Parliament, will deny U.S. products entry into the EU market and may seek to challenge them in the WTO.

The Bush Administration in late August 2001 reiterated its view that regulatory approaches toward products of biotechnology should be transparent, predictable, and based on sound science. Moreover, the administration made clear that it would mount an

⁴ Prepared by Charles E. Hanrahan, Senior Specialist in Agricultural Policy, Resources, Science, and Industry Division.

aggressive campaign against proposed EU labeling and traceability regulations by pressing the EU not to adopt regulations that would violate WTO rules or hurt U.S. exports. On February 7, 2002, USTR Zoellick stated that the United States is “very strongly” considering filing a formal dispute settlement complaint in the WTO over the EU’s failure to lift its moratorium on imports of GMOs. EU Trade Commissioner Pascal Lamy countered that U.S. action along these lines would be “immensely counterproductive” because it would be seen as a challenge to “consumer fears and perceptions.”

The April 2002 National Trade Estimates report, released by the Office of the U.S. Trade Representative, warned the U.S. is evaluating its next steps for altering the EU moratorium. A U.S. trade official defined that as including both continued consultations with the Commission, which is trying to unblock the approval process, as well as bringing a WTO case. Few observers predict a change in the EU approval process will occur this year.

On July 3, 2002 the European Parliament approved changes to a regulation on the tracing and labeling of biotechnology crops that would prevent any unapproved GM crops from being imported into the EU in trace amounts, impose stricter labeling requirements on processed foods derived from GMOs and create new hurdles to GMO approval. The action is likely to widen U.S.-EU differences over this issue.

E-Commerce and Data Privacy. The EU Council of Ministers in December 2001 reached agreement on a proposed directive on the taxation of e-commerce. The agreement was to adapt and apply existing taxes on e-commerce, not to levy any new or additional taxes as had been actively considered. The proposed directive considers that e-commerce transactions that do not involve the delivery of physical goods still constitute the provision of a service subject to each Member State’s value-added-tax (VAT). The VAT is a consumption tax payable on deliveries of goods and services. The proposed directive requires that non-EU suppliers register with a VAT authority in a single Member State. The VAT on digital products supplied from outside the EU would be levied at the rate applicable in the customer’s country of residence, and VAT revenue then reallocated from the supplier’s country of registration to that of the customer.

U.S.-based companies have questioned whether the proposed Directive treats U.S. suppliers of digital products less favorably than EU suppliers. One problem cited is that U.S. suppliers would be required to collect and remit the VAT at 15 different rates in accord with the consumer’s Member State of residence. By contrast, EU suppliers would only be obliged to collect and remit VAT at the rate of the single Member State in which that supplier is registered. If the Directive is formally adopted by Member States this year, it would likely be implemented by 2003.

The related issue of data privacy rights is also a source of friction. While the EU supports strict legal regulations on gathering consumer’s personal data, the United States has advocated a self-regulated approach. Controversy emerged when the EU adopted a directive forbidding the commercial exchange of private information with countries that lack adequate privacy protections. The issue appeared resolved by the “Safe Harbor” agreement of 2000, whereby U.S. companies that agree to abide by privacy principles can enter a safe harbor protecting them from the EU directive barring data transfers to countries that do not adequately protect citizens’ privacy. But U.S. companies have been slow to participate in the Safe Harbor by self-certifying to the Department of Commerce (only 35 had signed on

as of May 2002). Currently, only entities whose activities fall under the regulatory authority of the Federal Trade Commission or the Department of Transportation are eligible to participate in the Safe Harbor. Whether or how other sectors, particularly financial services, will be considered in relation to Safe Harbor has not yet been determined.

The U.S. financial services industry argues that existing U.S. laws (Gramm-Leach - Bliley Act and the Fair Credit Reporting Act) adequately protect data privacy. In a May 11, 2001 letter to Treasury Secretary Paul O'Neill, some Members of Congress expressed concern with the "EU's unwillingness to grant an adequacy determination to U.S. financial services firms." (For further discussion, see CRS Report RS20823, *The EU-US Safe Harbor Agreement on Personal Data Privacy*.)

Fostering a Receptive Climate for Mergers and Acquisitions

Consistent with the trend of increased globalization, U.S. and European companies have engaged in hundreds of mergers and acquisitions (M&A) in recent years. In 1999 European companies reportedly spent over \$200 billion on acquisitions of U.S. companies compared to U.S. company expenditures of \$90 billion for European companies. Although concerns regarding foreign control and ownership of companies in particular sectors, such as telecommunications or mass media, have been raised from time to time, M&A activity has been pretty much noncontroversial. That was until July 3, 2001, the day the European Commission blocked the merger of General Electric and Honeywell, opening a debate on the need for better U.S.-EU antitrust cooperation.

Enhanced Antitrust Cooperation

As M&A activity has accelerated in recent years among U.S. and European companies, the U.S. Justice Department and the European Union's competition directorate have worked closely in passing judgment on proposed deals. Pursuant to a 1991 bilateral agreement on antitrust cooperation between the European Commission and the United States, the handling of these cases has been viewed generally as a successful example of transatlantic cooperation. In reviews of several hundred mergers over the past 10 years, there has been substantial agreement between regulators in Brussels and Washington on antitrust decisions. However, the EU's recent rejection of General Electric's \$43 billion merger with Honeywell International has highlighted major differences in antitrust standards and processes employed by the EU and the United States. In the process, some observers have argued that the GE-Honeywell case points to a need for closer consultations or convergence in antitrust standards.

The GE-Honeywell merger would have combined producers of complementary aircraft components. GE produces aircraft engines and Honeywell makes advanced avionics such as airborne collision warning devices and navigation equipment. GE and Honeywell do not compete over any large range of products. The combined company arguably would have been able to offer customers (mostly Boeing and Airbus) lower prices for a package that no other engine or avionics company could match. In its review, the U.S. Justice Department

concluded that the merger would offer better products and services at more attractive prices than either firm could offer individually, and that competition would be enhanced.

With regard to the European Commission's merger review (which occurs over any merger between firms whose combined global sales are more than \$4.3 billion and that do at least \$215 million of business in the European Union), the legal standard employed for evaluating mergers is whether the acquisition creates or strengthens a company's dominant position as a result of which effective competition would be significantly impeded. The commission's Task Force on Mergers concluded that, together, GE-Honeywell's "dominance" would be increased because of the strong positions held by GE in jet engines and by Honeywell in avionics products.

EU antitrust regulators relied, in part, on the economic concept of "bundling" to reach its decision. Bundling is the practice of selling complementary products in a single, discounted package. The combined company makes more profits than the pre-merger companies and prices are lower, making consumers better off. But the EU concluded that the lower prices and packages of products that could be offered by the merged entity would make competition a lot more difficult for other producers of airplane equipment such as Rolls Royce, Pratt & Whitney, and United Technologies. In the long run, European regulators had concerns that the merger could force weaker competitors out of the market, thereby leaving GE-Honeywell free over time to raise prices.

GE officials countered that the commission relied on a theory that is not supported by evidence, particularly in the aerospace industry. Boeing and Airbus, for example, tend not to be weak or passive price takers, but are strong and sophisticated customers that negotiate all prices. And even if the new company offered discounted "bundled" packages, the winners would be the airlines and, ultimately, their customers.

In short, the GE-Honeywell case crystallized differences in standards and processes employed by antitrust regulators in Washington and Brussels. One of the most striking differences is that the European process clearly affords competitors more leeway to oppose mergers by allowing for testimony behind closed doors and places more weight on economic models that predict competition will be reduced and competitors eliminated in the long-run. U.S. antitrust regulators tend to presume that any post-merger anti-competitive problems can be taken care of later by corrective antitrust enforcement action.

Since the GE-Honeywell dispute, there have been few cases that have tested whether an emerging rift on antitrust policy may be developing. One reason is that M&A activity has been slow in 2001 and again this year to date. The next test, however, could be the EU's handling of the Microsoft case. The EU is expected to take action on Microsoft by year-end 2002. U.S. antitrust officials reportedly have been urging the EU to adopt sanctions modeled on the U.S. settlement.

Strengthening the Multilateral Trading System

After three years of efforts, including the ill-fated ministerial held in Seattle in 1999, trade ministers from the 142 member countries of the WTO agreed to launch a new round of trade negotiations last November in Doha, Qatar. At Doha the WTO members agreed to

launch a new round of trade negotiations and agreed to give priority attention to a number of developing country concerns.

By most accounts, U.S.-EU cooperation played a major role in producing agreement at Doha. USTR Zoellick and EU Trade Commissioner Lamy reportedly worked closely together, agreeing that making concessions to developing countries on issues of priority concern was necessary to move the trading system forward. Their cooperation began early in 2001 with the settlement of the long-running banana dispute and tacit agreement to settle other disputes without resort to retaliation. Each also recognized that both trading superpowers would have to make concessions at Doha to achieve their overall objectives.

At Doha, both the U.S. and EU shared the goal of liberalizing markets in which each enjoyed competitive advantages and to preserve as many protected and less advanced sectors as possible. To gain support from other WTO members, the United States agreed to allow negotiations on its trade remedy laws and on patent protection while the EU agreed to greater liberalization of the agricultural sector than some Member States wanted. Both also agreed to support a number of capacity building initiatives designed to help developing countries better take advantage of world trade opportunities.

The agenda agreed to at Doha calls for a comprehensive three-year negotiation to be completed by 2005. The negotiations will cover trade in services, industrial tariffs, and agriculture. The broad agenda provides scope for negotiators to derive balanced packages of concessions from all participating countries.

Agriculture is an issue that could prove divisive once the negotiations pick up momentum. Transatlantic trade tensions over agriculture delayed the conclusion of the Uruguay Round by several years in the early 1990s. The U.S. has been a longstanding demander for the liberalization of agricultural trade barriers and domestic support programs, while the EU has been reluctant to put agriculture on the negotiating agenda. However, passage of the 2002 farm bill could offset this standard calculation. As the bill increased subsidies for a number of major crops, U.S. farm support levels could well approach limits on farm support set by the Uruguay Round. Whether higher levels of U.S. farm spending will serve as a prod for further negotiations or provide the EU with an excuse to put agriculture on the negotiating table, with the politically difficult reform of the Common Agricultural Policy that would require, remains to be seen.

Accommodating Foreign Policy Sanctions That Have An Impact on Trade

U.S. legislation that requires the imposition of economic sanctions for foreign policy reasons has been a major concern of the EU. While the EU often shares many of the foreign policy goals of the United States that are addressed legislatively, it has opposed the extraterritorial provisions of certain pieces of U.S. legislation that seek to unilaterally regulate or control trade and investment activities conducted by foreign companies outside the United States. Most persistent EU complaints have been directed at the Cuban Liberty and Democratic Solidarity Act of 1996 (so-called Helms-Burton Act) and the Iran and Libya

Sanctions Act (ILSA), which threatens the extraterritorial imposition of U.S. sanctions against European firms doing business in Cuba, Iran, and Libya.

In May 1998 the EU reached an understanding with the Clinton Administration concerning Helms-Burton and ILSA. Regarding Helms-Burton, the Clinton Administration agreed to continue to waive Title III (at six month intervals, as allowed by law), which allows lawsuits for damages in U.S. courts over investment in expropriated U.S. property in Cuba, in order to avoid a major dispute with the EU. The Clinton Administration also pledged to work with Congress to amend the law's provision (Title IV) barring entry into the United States of executives working for companies that have invested in property confiscated by the Cuban government. This permanent waiver of Title IV would be undertaken in exchange for the EU's efforts to promote democracy and human rights in Cuba. The understanding also tried to insulate the EU from sanctions under ILSA, which threatened sanctions on foreign oil companies that invest more than \$20 million in one year in Iran's energy sector, or \$40 million in one year in Libya's energy sector.

EU Commissioner for External Affairs Christopher Patten called on the Bush Administration to endorse the 1998 understanding at a March 6, 2001 press conference. President Bush, in turn, has continued to suspend implementation of Title III. On July 16, 2001, President Bush made the decision to continue to suspend the implementation and cited efforts by European countries and other U.S. allies to push for democratic change in Cuba. On January 16, 2002, President Bush once again suspended implementation of Title III for a six-month period. Concerning ILSA, the House and Senate both passed bills (H.R. 1954, S. 1218) extending ILSA for an additional five years. H.R. 1954, also provides for termination of the bill with the passage of a joint resolution of the Congress. (For further information, see CRS Report RS20871, *The Iran-Libya Sanction Act (ILSA)*, by Kenneth Katzman.

FOR ADDITIONAL READING

CRS Reports

CRS Report 98-861ENR *U.S.-European agricultural trade: food safety and biotechnology issues*, by Charles E. Hanrahan.

CRS Report RL30753. *Agricultural support mechanisms in the European Union: a comparison with the United States*, by Geoffrey S. Becker.

CRS Report RL30547. *Aircraft hushkits: noise and international trade*, by John W. Fischer.

CRS Report RL30608. *EU-U.S. economic ties: framework, scope, and magnitude*, by William H. Cooper.

CRS Report RS21185. *Trade policymaking in the European Union: Institutional arrangements*, by Raymond J. Ahearn.

CRS Report RS21223. *U.S.-EU trade tensions: causes, consequences and possible cures*, by Raymond J. Ahearn.

Other Reports

The Atlantic Council of the United States. *Changing Terms of Trade: Managing the New Transatlantic Economy*, Policy Paper, April 2001, 32p.