

# CRS 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. In the past, U.S.-EU trade relations have witnessed periodic episodes of rising trade tensions and even threats of a trade war, only to be followed by successful efforts at dispute settlement. This ebb and flow of trade tensions has occurred again last year and this year with high-profile disputes involving steel, tax breaks for U.S. exporters, and the EU ban on approvals of GMO products. Resolution of U.S.-EU trade 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 sound basis for effective and timely dispute resolution. How foreign policy discord over the Iraq war may affect economic relations is a major new unknown. In order to build a smoother relationship, Brussels and Washington may have to resolve a number of these disputes and avoid an outbreak of tit-for-tat retaliatory actions. The agreement to launch a new round of multilateral trade negotiations

at the World Trade Organization (WTO) trade ministerial held November 2001 in Doha, Qatar has facilitated this effort. But the recent passage of U.S. legislation increasing farm subsidies, as well as the continuing EU moratorium on approval of new genetically modified crops, could complicate efforts to move the Doha Round forward and thwart the new round's potential beneficial impact on resolving other disputes. Currently, the EU has warned the United States to act this year on repealing a tax provision that has been found to be a prohibited export subsidy under WTO rules or face trade retaliation on \$4.043 billion of exports to Europe. Similarly, the EU has maintained that U.S. failure to repeal a steel safeguard (the Bush Administration's March 5, 2002 decision to impose temporary tariffs of up to 30% on approximately \$8 billion in steel imports) if the WTO determines later this year that the safeguard action violates U.S. world trade obligations would also lead the EU to retaliate against U.S. exports. In addition, the Bush Administration on May 13, 2003 moved the dispute involving the EU's - failure to open its market to genetically modified food products to the WTO. The major U.S.-EU trade challenges can be grouped into five categories: (1) avoiding a "big ticket" trade dispute associated with steel or the tax breaks for U.S. exporters; (2) resolving long-standing trade disputes involving aerospace 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 (5) strengthening the multilateral trading system.



## **MOST RECENT DEVELOPMENTS**

The WTO ruled on July 11, 2003 that U.S. steel tariffs imposed in March 2002 were illegal. The United States is expected to appeal this decision.

An EU trade official stated on July 8, 2003 that the EU has no plans to submit new proposals to the WTO agriculture negotiations despite having agreed to plans last month to reform its Common Agricultural Policy.

EU agriculture ministers agreed on June 26, 2003 to approve changes in the Common Agricultural Policy that would partially cut the link between subsidies and production for arable crops beginning no later than 2007.

Following consultations with the EU on its moratorium blocking the marketing approval of biotechnology products, the Bush Administration announced on June 19, 2003 that it will request a dispute settlement panel in the WTO.

President Bush in a May 21, 2003 speech blamed the EU ban on new genetically-engineered products and agricultural export subsidies for hindering the fight against hunger in Africa.

The Bush Administration on May 13, 2003 requested consultations with the EU under the auspices of the WTO in an effort to pressure the EU to lift its longstanding moratorium on the approval of new genetically-engineered products.

On May 9, 2003, EU Trade Commissioner Pascal Lamy said that the EU would decide in the fall whether the United States had made enough progress towards repealing its Foreign Sales Corporation statute and its successor regime in order to avoid retaliation.

The World Trade Organization authorized the European Union to retaliate against U.S. exports worth \$4.043 billion in a special session of the Dispute Settlement Body on May 7, 2003.

Senate Finance Committee Chairman Chuck Grassley demanded on May 6, 2003 that the Bush Administration set within two weeks a "date certain" for filing a WTO challenge against the European Union's moratorium on approvals of biotechnology.

U.S. Trade Representative Robert Zoellick stated on March 3, 2005 that U.S. patience over the EU's failure to lift its moratorium on approvals of genetically modified food products is running thin.

The European Commission on February 26, 2003 submitted for approval by European Union member states its plans for imposing possible sanction targeting about \$4 billion in U.S. exports to Europe if the United States continues to fail to comply with a WTO ruling against U.S. tax legislation for U.S. exporters.

## **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. In the past, U.S.-EU trade relations have witnessed periodic episodes of rising trade tensions and conflicts, only to be followed by successful efforts at dispute settlement. This ebb and flow of trade tensions has occurred again last year with the high-profile disputes involving steel and tax breaks for U.S. exporters.

The two sides still face a major challenge this year in keeping the relationship on an even keel. 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, festering trade disputes may complicate continuing U.S.-EU cooperation on this front. The upcoming (September 10-14, 2003) WTO ministerial meeting in Cancun could substantially affect the climate for effective U.S.-EU cooperation on trade issues in the near term. The 108<sup>th</sup> Congress in its response to EU practices, demands to bring U.S. laws in compliance with WTO obligations, 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 2002. 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 in high-technology and sophisticated product areas where incomes and tastes are the primary determinants of market success.

Based on a population of some 378 million citizens and a gross domestic product of about \$7.9 trillion (compared to a U.S. population of 285 million and a GDP of \$10.2 trillion) in 2001, 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. By 2004, with enlargement to 25 countries, the EU market will grow to 450 million consumers and will 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 2001, the total stock of two-way direct investment reached \$1.45 trillion (composed of \$871 billion in EU investment in the United States and \$628 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 4.0 million Americans who are employed by European companies and almost 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. (The U.S. retaliation for bananas was lifted in 2001 but \$116 million in punitive duties remains in effect due to the beef dispute.) 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, the U.S. export tax subsidy, and the EU ban on imports of genetically modified organisms (GMOs) are at the top of the list of bilateral challenges. The Bush Administration's March 5, 2002 decision to impose temporary tariffs of up to 30% on approximately \$8 billion in steel imports was angrily criticized by the EU. The EU and seven other steel-exporting countries filed a WTO case against the U.S. protective tariffs, claiming that they violated WTO rules. A WTO panel has found that the U.S. action violated various safeguard rules involving an increase in imports and a link between imports and injury to the domestic industry. The Bush Administration has appealed this ruling. A final ruling is expected to be issued by the Appellate Body by the end of the year. If the U.S. loses the appeal, the EU could win a second WTO authorization to impose countermeasures on U.S. exports.

On the basis of a May 7, 2003 WTO final ruling, the EU now has legal authority to retaliate against \$4 billion in U.S. exports to the EU. This is due to the failure of the United States to date to bring its export tax subsidy provision, known as the Foreign Sales Corporation (FSC), and its replacement regime (the ETI or extraterritorial income) in conformity with WTO rules. Currently, two coalitions of U.S. companies are backing different legislative approaches as an alternative to the FSC and its successor regime, but it remains unclear whether a consensus approach will be arrived in the 1<sup>st</sup> session of the 108<sup>th</sup> Congress..

The third dispute involves the EU's longstanding moratorium on the approval of new genetically modified organisms (GM Os). After considerable congressional pressure for filing a WTO case against the EU for this ban, the Bush Administration on May 13, 2003 requested consultations with the EU under the WTO's dispute settlement process. On June 19, 2003, the Bush Administration announced that it will request the establishment of a dispute settlement panel in the WTO. Although the EU Parliament on July 2, 2003 approved rules on the traceability and labeling of GMOs that may pave the way for the lifting of the EU moratorium, U.S. agricultural interests have not been mollified because they believe that the new rules may be just as restrictive as the moratorium.

## **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; and strengthening the multilateral trading system. 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.**<sup>1</sup> 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 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 2001 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

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<sup>1</sup> Prepared by Stephen Cooney, Industry Analyst, Resources, Science, and Industry Division.

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 the EU to challenge the U.S. action in the WTO. The EU charged that the U.S. had failed to show an increase in imports, failed to adequately establish the link between imports and injury to the domestic steel industry, and had included import figures from Canada and Mexico in its injury investigation but then not included them in the remedy because they are signatories to the North American Free Trade Agreement.

The EU threat was based on a WTO provision that permits countries to demand compensation for safeguard measures for vulnerable industries, like steel, if they are not done in response to an "absolute increase in imports." The EU argues that U.S. steel imports have declined since 1998. But the Bush Administration maintains that retaliation is a legal matter that has to be determined by normal WTO dispute settlement procedures, a process that could take up to two years.

In an interim ruling in March 2003 and in a final ruling in July 2003, the WTO dispute panel ruled against the United States. The ruling now goes to an appellate body of the WTO that is expected to give its ruling in late November or early December. If this ruling also goes against the United States, the European Union is likely to impose sanction on U.S. exports worth as much as \$2.2 billion if the safeguard tariffs are not lifted. Even though the United States has granted exemption to over half the steel exported from Europe, EU officials have made clear their determination to impose sanctions if the tariffs are not lifted.

**U.S. Tax Benefits for Exports.**<sup>2</sup> 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.

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

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 was intended to achieve WTO compliance. However the EU maintained that the ETI provisions provide an export subsidy in the same manner as the FSC, and has asked the WTO to rule against it. The WTO next ruled in January 2002 that the ETI was no better than the FSC because it still gave a selective break to exporters. And as a result of the U.S. violation, the WTO ruled on May 7, 2003 that the EU can impose \$4.043 billion in punitive duties on U.S. exports to Europe immediately.

While the EU has drawn up a detailed list of U.S. exports that could be subject to punitive tariffs, EU officials have made clear that they are more interested in compliance than in retaliation. EU Trade Commissioner Pascal Lamy has stated that the EU would decide in the fall whether the U.S. has made enough progress towards repealing the FSC and ETI statutes to avoid retaliation. But the threat of sanctions could supply the United States with more incentive to bring the tax provision in conformity with world trade law.

In the 108<sup>th</sup> Congress, two different approaches are under consideration to comply with the WTO rulings on FSC-ETI. One approach is being advanced by Rep. Bill Thomas, the Chairman of the House Ways and Means Committee. While Mr. Thomas has not yet introduced legislation, his approach reportedly would repeal the FSC-ETI statutes and use the funds generated to rewrite international aspects of the tax code, including provisions that would include expansion of foreign source income on which companies could defer paying taxes immediately. A different approach as embodied in H.R. 1769 and as introduced by Reps. Phil Crane and Charles Rangel, would use funds generated by the repeal for a manufacturing tax credit to reduce corporate taxes by 10% for companies that produce exclusively in the United States. Because these two approaches have a differential impact on large corporations (the Thomas approach arguably could favor companies such as General Motors and Coca Cola that have major overseas operations, while the Crane-Rangel approach reportedly would favor companies such as Caterpillar and Boeing that have operations primarily in the United States), Congress has so far had difficulty in reaching a consensus on one approach or the other. (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 and next.

**Airbus-Boeing Subsidy Tensions.**<sup>3</sup> 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 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. And in 2003, after two decades of trying, Airbus is likely to deliver more commercial airplanes than Boeing.

The dispute between the United States and the European governments participating in the Airbus consortium is of long standing. The basic premise of the dispute 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.

Airbus does not accept the U.S. view of the reasons for its success. Although admitting to, but not publically disclosing, the level of direct subsidies from supporting governments, Airbus contends that it is in the market for long-term profit. Airbus points to the loan repayments it has provided over the last several years as proof of its long-term intent to operate in a market environment. Airbus counters the U.S. argument that subsidies are the principal reason for Airbus' success with claims that U.S. manufacturers have benefitted from huge indirect governmental subsidies in the form of military and space contracts and government-sponsored aerospace research and development.

The Airbus A380 will be offered in several versions seating between 500 and 800 passengers. Airbus has almost 100 firm orders for the aircraft. The project is expected to cost at least \$10.7 billion. Airbus expects its members will provide 60% of the sum, with the remaining coming from subcontractors. State-aid from European Governments will also be a source of funding for Airbus member firms. State-aid is limited to one-third of the project's total cost by a 1992 U.S.-EU Agreement on Government Support for Civil Aircraft.

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

At issue in the A380 development is at least \$2.5 billion in already identified direct loans to be provided to Airbus member firms by the governments of France, Germany, Spain, and the United Kingdom. Additional funds are likely to be provided to subcontractors by other EU members such as Belgium and Italy. In December 2000, then President Clinton expressed concerns that the loans to be supplied for the A380 would not be at commercial rates and that they might be forgiven if the A380 is a commercial failure. So far, the Bush Administration has expressed similar concerns, but has taken no additional actions. The EU provided information in April 2001 that it claimed showed that all state-aids to be provided would fully comply with the 1992 Civil Aircraft Agreement. (For further discussion, see CRS Electronic Briefing Book on *Trade*, which is available on the CRS web site at [<http://www.congress.gov/brbk/html/ebtra121.html>], *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.

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.

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.

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 towards a resolution. This arguably could shield USTR from congressional and private sector pressures to apply the carousel provision against the EU.

On August 2, 2002, eleven senators, including Senate Minority Leader Trent Lott and Senate Finance Committee Chairman Max Baucus, called on the Bush Administration to increase the level of retaliation for the EU's ban on beef imports to adjust for the additional trade that will be lost when new countries join the EU. The Senators also suggested that the U.S. should implement the carousel provision of U.S. trade law.

In a new development, the EU reportedly plans to ask the WTO sometime in 2003 to require the United States to lift sanctions despite the existing ruling against the ban. Some EU officials have said that the decision will be based on new scientific evidence showing that the six hormones – oestradiol-17-beta, progesterone, testosterone, zeranol, trenbolone, and melengestrol acetate – pose a significant risk to public health. While this dispute was discussed at the June 25, 3003 U.S.-EU Summit in Washington, no progress was reported in resolving the issue. (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.**<sup>4</sup> Differences between the United States and the EU over genetically modified organisms (GMOs) 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

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

are pronounced differences between the United States and EU about GMO products and their potential health and environmental effects.

Widespread farmer adoption of bio-engineered crops in the United States makes consumer acceptance of GMO crops and foods at home and abroad critical to producers, processors, and exporters. U.S. farmers use GMO crops because they can reduce input costs or make field work more flexible. Supporters of GMO 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 GMO 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 GMO 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 GMO 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 GMO ingredients. Subsequently, the EU has put in place legislation to restart the process of approving GMO crop varieties, but has yet to complete regulations on labeling GMO foods and for tracing GE crops through the food chain. The EU Commission has prepared regulations for approving products of agricultural biotechnology that, once approved, would come into effect in October, 2002. At that point, according to the EU Commission, approvals could be progressively “unblocked.” Some EU member states might still object to such approvals, however. Also the EU Parliament has recently voted to toughen the Commissions proposed rules on tracing and labeling bio-engineered crops and to make the approval process more difficult. Differences between the Commission and the Parliament will have to be reconciled before the new rules take effect. On July 25, 2001, the European Commission proposed stringent rules on labeling and traceability of GMO 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 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.” During October 2002, Zoellick reportedly told European officials that the United States may bring the issue to the WTO by the end of the year. On December 3, 2002, the Trade Policy Review Group, a sub-cabinet trade policymaking entity, decided to ask a higher level Cabinet inter-agency trade group to make the final recommendation. On January 21, 2003, Zoellick told reporters that he

expected that the Administration would decide whether or not to challenge the de facto moratorium on biotechnology approval within a few weeks. Senate Finance Committee Chairman Chuck Grassley demanded on May 7, 2003 that the White House set within the next two weeks a “date certain” for filing a WTO challenges against the moratorium. And then on May 13, 2003, the Bush Administration requested consultations with the EU under the auspices of the WTO. Unless the EU lifts the moratorium before the 60-day consultation period is over, the U.S. is likely to proceed with a panel in the WTO against the EU. In addition, President Bush in a May 21, 2003 speech blamed the EU ban and EU export subsidies for hindering the fight against hunger in Africa.

The most recent development in this dispute was action taken on July 2, 2003 by the European Parliament to approve certain traceability and labeling rules for GMOs. In the view of many European officials, these rules will set the stage for the ending of the moratorium. U.S. agricultural producers, however, have argued that the new rules are just as restrictive as the moratorium and may also be challengeable in the WTO. (For further discussion, see CRS Report 98-861, *U.S. -European Agricultural Trade: Food Safety and Biotechnology Issues*).

**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 such as software or computer games supplied over the Internet 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. Another concern is that non-EU companies could be forced to charge higher VAT rates to European customers than would European retailers.

If the Directive is formally adopted by Member States this year, it would likely be implemented by 2003. In the interim, nine members of the House Subcommittee on Commerce, Trade and Consumer Protection wrote the Bush Administration on July 25, 2002 that the EU proposal raises “grave concerns that additional barriers are being imposed on electronic commerce.”

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 217 had signed on as of August 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.” Negotiations between the U.S. and EU, however, are currently taking place and differences over providing coverage for financial institutions under the Safe Harbor agreement reportedly have been narrowed. (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 2000, 60 deals in excess of \$1 billion were completed, with over two-thirds involving a European acquisition of an American company. 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. In terms of standards, in the United States, a merger could be acceptable if it results in efficiencies that regulators were convinced would lower prices to consumers, even if competition in the marketplace might adversely be affected. In Europe, however, the governing regulation requires the competition commissioner to block a merger if he determines that it will "create or strengthen a dominant position." This is based on a concern that "dominance" increases the likelihood of "consumer abuse." Regarding process, 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. In contrast, 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.

On October 30, 2002, the U.S.-EU Merger Working Group, formed in the aftermath of GE-Honeywell, issued a series of non-enforceable approaches to merger review. Importantly, the group findings emphasized that when transactions are reviewed in both the U.S. and EU, "both jurisdictions have an interest in reaching, insofar as possible, consistent,

or at least non-conflicting outcomes.” The next test of meeting this objective could be the EU’s decision on the Microsoft case, which is expected in a few months. 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.

The United States is calling for cutting tariffs on farm good dramatically, with deeper cuts for the highest tariffs; limiting trade-distorting domestic supports and eliminating certain export subsidies. The EU and other WTO members are calling for a more gradual approach to agricultural policy reform.

Beyond agriculture, Washington and Brussels will have differences on many other issues. These range from how to change international dispute settlement rules to the

treatment of environmental rules in the WTO. At the same time, the two sides have similar interests in an ambitious result on liberalizations of trade in goods and services.

The upcoming WTO ministerial meeting in Cancun is the first meeting of all 146 ministers since Doha. U.S.-EU agreement on how to move the negotiations forward is likely to be necessary if meeting is to be successful.

## **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, 32 p.

The Atlantic Council of the United States. *Risk and Reward: U.S.-EU Regulatory Cooperation on Food Safety and the Environment*, Policy Paper, November 2002, 35 p.