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

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CONTENTS

SUMMARY

MOST RECENT DEVELOPMENTS

BACKGROUND AND ANALYSIS

Overview
- Closer Economic Ties
- Growing Strains
- Current Trade Agenda

Major Issues and Policy Challenges
- Complying With WTO Rulings
  - U.S. Tax Benefits for Exports
  - Byrd Amendment
- Resolving Longstanding Disputes
  - Airbus-Boeing Subsidy Tensions
  - Beef Hormones
- Dealing with Different Public Concerns Over New Technologies and New Industries
  - Bio-technology
  - E-Commerce and Data Privacy
- Fostering Cooperative Competition Policies
- GE-Honeywell Case
- Microsoft Case

Strengthening the Multilateral Trading System

FOR ADDITIONAL READING
- CRS Reports
- Other Reports

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 benefits 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. Whether foreign policy discord over the Iraq war may affect economic relations is also a major new unknown.

Both European Trade Commissioner Pascal Lamy and U.S. Trade Representative Robert Zoellick have been working to get the Doha Round of multilateral trade negotiations re-started after last September's failed Cancun WTO meeting. A major concern is that failure to move the WTO talks forward may invite new dispute resolution cases, particularly in the agricultural area that has been so contentious between Brussels and Washington in the past.

On March 1, 2004, the EU began imposing 5% additional duties on selected U.S. exports in response to a WTO ruling that certain tax provisions for exports were illegal. Congress is actively considering legislation that would bring U.S. tax law in conformity with WTO obligations. The EU is also moving to impose retaliatory tariffs of U.S. exports as a result of U.S. failure to date to comply with a WTO ruling striking down the so-called Byrd Amendment. On May 19, 2004 the EU approved a GM sweet corn known as Bt-11. However, with regulations on labeling and traceability in effect, the commercial significance of the EU approval of Bt-11 remains uncertain.

Major U.S.-EU trade challenges can be grouped into five categories: (1) complying with WTO rulings; (2) resolving longstanding trade disputes involving aerospace production subsidies and beef hormones; (3) dealing with different public concerns over new technologies and new industries (4) fostering cooperative competition policies; and (5) strengthening the multilateral trading system.

Most Recent Developments

The European Union approved a GM sweet corn known as Bt-11. With regulations on labeling and traceability in effect, the commercial significance of this approval, the first GMO approval in six years, remains unclear.

The Senate passed legislation (S. 1637) that repeals the Extraterritorial Income Exclusion (ETI). The 92-5 vote is considered an important step in bringing the U.S. tax code into compliance with a WTO ruling the ETI amounts to an illegal export subsidy.

The European Union announced May 10, 2004, that it is prepared to negotiate the elimination of all export subsidies as part of an effort to inject new momentum into the WTO negotiations on agricultural trade.

Major business organizations on both sides of the Atlantic on April 30, 2004, called for the creation of a "barrier-free" trans-Atlantic marketplace, maintaining that global economic prosperity depends on strong commercial ties between the United States and European Union.

The EU Commission on March 24, 2004 imposed remedies and fines on Microsoft for infringement of European competition rules.

The EU on March 1, 2004, began imposing an additional tariff of 5% on over 1,600 U.S. exports to the EU in response to Washington's failure to repeal tax breaks for U.S. exporters that the WTO had ruled are illegal.

The WTO on February 24, 2004, provided the European Union the right to impose sanctions on U.S. exports as a result of Washington's failure to comply with a WTO ruling on the 1916 Antidumping Act. However, the ruling limited the scope of the sanctions greatly, making it unlikely that any will be imposed.

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 in the months ahead in keeping the relationship on an even keel. On March 1, 2004 the EU began imposing an additional 5% tariff on imports of selected U.S. products valued at $4 billion over the so-called FSC/ETI export subsidy dispute. The EU is also pushing ahead with possible retaliatory actions in conjunction with another WTO compliance case — the Byrd Amendment which distributes anti-dumping duties imposed by the U.S. to U.S. petitioners and which was found to contravene WTO rules. For its part, the United States is pressing the EU to end its de facto moratorium on genetically modified organisms (GMOs) by requesting the selection of panelists to rule on this WTO complaint. The congressional response to EU 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 trillion in 2003. 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 450 million citizens and a gross domestic product of about $9.0 trillion (compared to a U.S. population of 289 million and a GDP of $10.2 trillion) in 2002, the twenty-five 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.

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 2002, the total stock of two-way direct investment reached $1.67 trillion (composed of $964 billion in EU investment in the United States and $708 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 4.4 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. Resolution of disputes involving the U.S. export tax subsidy, the Byrd Amendment, and the EU ban on imports of genetically modified organisms (GMOs) are at the top of the list of bilateral challenges.

The EU on March 1 imposed retaliatory tariffs of 5% on selected U.S. exports in the dispute over U.S. compliance with a WTO ruling involving the Foreign Sales Corporation (FSC) and its successor Extraterritorial Income Exclusion (ETI) export tax regime. Unless Congress repeals these export tax provisions, the EU plans to increase the tariff being applied on some 1, 607 different products by 1 percentage point per month until it reaches 17% by March 2005. A tariff of 8% is currently (June 2004) being imposed. Both the Senate and House are considering legislation that repeals the tax break provisions.

A second dispute stems from a successful EU challenge (supported by other countries) in the WTO of a U.S. law (so-called Byrd Amendment) that distributes duties from trade remedy (anti-dumping and countervailing duty) cases directly to the petitioning companies instead of to the U.S. Treasury. The United States was given until December 27, 2003, to comply with the ruling, but Congress to date has not taken up legislation that would bring the U.S. into conformity with its WTO obligations. In January 2004, eight of the complaining countries asked the WTO for authorization to impose retaliatory measures. U.S. trade officials have expressed skepticism that the Byrd Amendment has had any actual impact on trade and have argued that the co-complainants should be denied the right to retaliate. The Bush Administration has indicated that it will try to reverse the WTO ruling by securing the right of governments to distribute monies collected on trade remedy cases to affected firms as part of the ongoing Doha round of negotiations.

The third dispute involves the EU's longstanding moratorium on the approval of new genetically modified organisms (GMOs). The de facto ban has caused U.S. corn exports to the EU to decline to minimal levels after averaging $300 million per year prior to the ban. 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. The consultations were not successful so on August 7, 2003, the Bush Administration requested the establishment of a dispute settlement panel in the WTO. After being unable to come to an agreement with the EU on a mutually acceptable slate of panelists, the United States, Argentina, and Canada on February 23, 2004, requested the WTO to select the panelists.

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. With the EU's new rules on traceability and labeling having gone into effect this year, U.S. agricultural trade associations are pressing the Bush Administration to challenge the provisions in the WTO. While the May 19, 2004 decision by the EU to approve the GM sweet corn known as Bt-11 may technically end the moratorium, it is not clear what commercial significance, if any, this step will have. Some 33 applications for GM imports into the EU are still pending.

Major Issues and Policy Challenges

Major EU -U.S. trade and investment issues and policy challenges can be grouped into six different categories: (1) complying with WTO rulings; (2) resolving two longstanding trade disputes; (3) dealing with disputes involving new technologies or industries; (4) fostering cooperative competition policies; and (5) strengthening the multilateral trading system. A summary and status update of each challenge follows.

Complying With WTO Rulings

Perhaps the most serious trade disputes that currently cloud the bilateral relationship deal with WTO dispute compliance. While the United States has complied with adverse rulings in most WTO disputes, there are a number of outstanding disputes where this has not

been the case. The same can be said of the EU compliance record (see treatment of the beef hormone dispute below). U.S. tax benefits for exporting and the Byrd amendment are two key compliance disputes that involve retaliation or threats of retaliation.

U.S. Tax Benefits for Exports. The EU on March 1, 2004 began imposing retaliatory duties of 5% on selected U.S. exports in the dispute over U.S. compliance with a WTO ruling involving the Foreign Sales Corporation (FSC) and its successor Extraterritorial Income Exclusion (ETI) export tax regime. Unless Congress repeals these tax provisions or makes them WTO-compliant, the EU plans to increase the tariff being applied to some 1,607 different products by 1 percentage point per month until it reaches 17% by March 2005.

The EU FSC/ETI retaliation list appears much more diffuse in terms of geographic impact on producers and states than in the case of its steel retaliation list. The former list tilts heavily towards a large number of products that seemingly could be made just about anywhere in the United States, while the latter list was concentrated in a few states arguably pivotal to next November's election. The fact that Congress, not the President as in the case of the steel tariff issue, has to take action to bring U.S. law into conformity with WTO obligations may account for the different approaches taken by the EU in drawing up a retaliation list.

Congress is actively working on legislation that would eliminate the illegal export tax benefit. The Senate passed by a vote of 92-5 a repeal bill (S. 1637) on May 11, 2004. House Ways and Means Committee Chairman Bill Thomas reportedly plans to introduce a new version of repeal bill approved by the committee last October in the first or second week of June with a possible floor vote taking place in the third or fourth week of June. (For further discussion, see CRS Report RS20746, *Export Tax Benefits and the WTO.)*

Byrd Amendment. The Continued Dumping and Subsidy Offset Act (CDSO), or Byrd Amendment, enacted in October 2000, requires the annual disbursement of antidumping and countervailing duties to qualified petitioners in the underlying trade remedy proceedings. Soon after enactment, the EU and other parties successfully challenged the statute in the WTO. Because the United States did not comply with the ruling by the arbitrated deadline of December 27, 2003, eight complaining members requested authorization from the WTO in January 2004 to impose retaliatory measures.

The Bush Administration has proposed repeal of the CDSOA in its FY2004 and FY2005 budget requests. At the same time, the Administration has indicated its intent to reverse the WTO ruling against the Byrd amendment by securing the right of governments to distribute monies collected on antidumping and countervailing duties to affected firms as part of the ongoing Doha round of trade negotiations. In addition, considerable congressional opposition has been expressed to elimination of the measure, as evidenced by a letter signed by more than two-thirds of the Senate expressing opposition. (For further discussion on the Byrd amendment, see *Continued Dumping and Subsidy Offset Act (Byrd Amendment)* in the CRS Trade Briefing Book, [http://www.congress.gov/brbk/html/ebtra134.html].)

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.[1] 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 so-called sonic cruiser, which has since been cancelled. 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 allegedly 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 Industrie.

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.

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 European nations 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 U.S.-EU Agreement on Government Support for Civil Aircraft.

Shortly after the A380 project was announced, Boeing dropped its support of a competing new large aircraft. At the time, it decided instead to focus on the development

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[1] Prepared by John W. Fischer, Specialist in Transportation, Resources, Science, and Industry Division.

of a new class of higher speed commercial aircraft, the so-called sonic cruiser, which has since been cancelled. Boeing, which apparently believes the market for A380 size aircraft is limited, is now offering airlines a new technology 250-seat aircraft, the 7E7, which is viewed as a replacement for the 767. As of this writing, no specific order for this aircraft have been received and a decision to actually produce the aircraft is still pending.

Airbus does not accept the U.S. view of the reasons for its success. (Airbus now leads Boeing in both new annual aircraft deliveries and orders). 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.

Europeans are also likely to contend that the 7E7, if it is built, will receive a level of subsidy that they believe might proportionately exceed the subsidy levels received by the A380. To support this claim, they point to over $3 billion in publically announced subsidies from Washington State for 7E7 manufacturing facilities and large announced Japanese government subsidies for Japanese manufacturing firms who may serve as major subcontractors on the aircraft.

To date, both sides continue to refrain from challenging their respective programs in the WTO. Defense industry connections that both Boeing and Airbus have may complicate the dispute. For Boeing, the decision by the Air Force to lease 20 military tanker versions of the B767 aircraft and purchase 80 more has been controversial. Critics of this deal contend that the Air Force could have found comparable aircraft at cheaper price and that the real intent of the deal is to keep Boeing's 767 production line open during the ongoing industry downturn. Supporters of the sale believe that the 767 is a good platform for a military tanker and that its ready availability will efficiently fill an important national defense need.

Airbus, for its part, has its own military subsidy issue. Several European nations have decided to develop and acquire180 model A400M military transport aircraft at a cost of approximately 20 billion euros. This aircraft is viewed by many as comparable in many respects to the existing, but smaller and potentially cheaper, U.S. built Lockheed Martin C-130. Airbus also has announced that the engines for this aircraft would be produced by a European firm whose product would cost fully $1 billion more than that offered by Pratt&Whitney, Canada, which believed it had the inside track for the contract. North American critics may regard this move as blatant subsidy. (For further discussion, see CRS Electronic Briefing Book on *Trade*, which is available on the CRS website 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 October 2003, the European Commission notified the WTO that it has changed its hormone ban legislation in a way that it believes complies with international trade rules. The legislation makes provisional a previous permanent ban for five growth hormones used to raise beef and keeps in place a permanent ban on the use of oestradiaol 17 on the basis that it is carcinogen. As a result, the EU argued that it should no longer be subject to punitive trade sanctions by the United States (as well as by Canada).

At a November 7, 2003 meeting of the WTO's Dispute Settlement Body, the United States argued that the EU directive announcing that it is now in compliance still does not present an appropriate risk assessment as required by the SPS agreement for instituting a ban. The United States also charged that the EU merely renamed its permanent ban a provisional ban, which is not a vehicle for coming into compliance. Thus, the dispute currently appears no closer to resolution.(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.[2] 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 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.

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

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.

With minor exceptions, the EU has approved no GMO products since 1998, even though it has an elaborate approval process in place. (On May 19, 2004, the EU approved the import of canned Bt sweet corn, an action that the U.S. argues did not end the general moratorium.) In October 2002, the EU implemented revisions to that process aimed at reassuring its member states and the public about the safety of its regulatory system. Nonetheless, a block of EU countries continued to halt the release of any new GMO crops into the environment. These countries said they would not implement the EU-wide legislation for approvals until new, stricter, regulations for labeling and tracing GMO containing products are implemented. The EU Council of Ministers adopted these regulations on July 22, 2003. They came into force on November 7, 2003, and are expected to take effect in spring 2004.

As of November 2003, 20 GMO applications were awaiting EU authorization, several since 1996 or 1997. Prior to the moratorium, the EU said it had approved 18 GMOs for deliberate release into the environment: some for cultivation, and some for import and processing, feed, and/or food. Among the products still awaiting approval are Monsanto's Roundup Ready corn and cotton, Pioneers Bt corn, and Bayer Liberty Link soybeans, all widely used in the United States, Canada, and Argentina.

Due to the moratorium, the United States, Canada, and Argentina, in August 2003, initiated a case before the WTO. U.S. agricultural interests contend that not only have these policies blocked their exports to the EU, but also fueled unwarranted concerns about the safety of biotechnology throughout the world. U.S. interests contend that there is no scientific evidence that GMO foods and crops are substantially different from, or any less safe than, conventional varieties. EU officials say they have been moving as quickly as possible to reinstate biotechnology approval while trying to reassure their consumers regarding safety issues. On February 23, 2004, the three co-complainants asked the WTO to appoint the panelists after they were unable to agree on a mutually acceptable slate. In an April 8, 2004 ruling, the WTO rejected EU claims that the petition for a panel was not justified. In May 2004, the panel began receiving and reviewing submissions from both sides to the dispute.

The U.S.-led WTO case does not involve the new labeling and traceability regulations that will require most food, feed and processed products from GMOs to be labeled (meat and livestock are exempt). However, as of March 2004, the American Soybean Association is reportedly taking the lead in preparing a WTO challenge. The U.S. trade association argues that, even if the GMO approval moratorium is lifted, the new labeling and traceability rules are themselves unworkable and unnecessary, and can mislead consumers by wrongly inferring that GMO products are inherently different than non-GMO foods or pose safety concerns. More formally, the group is likely to charge that the regulations violate the WTO's Agreement on Technical Barriers to Trade (TBT) and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS). At this time, it is not known whether the Office of the U.S. Trade Representative would accept the case. (For further discussion, see CRS Report 98-861, *U.S. -European Agricultural Trade: Food Safety and Biotechnology Issues).*

E-Commerce and Data Privacy. On July 1, 2003, the EU began requiring U.S. and other non-EU firms to pay value added tax (VAT) on the sale of goods and services digitally delivered to individual consumers in the EU. The new tax rules apply to the supply over electronic networks (digital delivery) of software and computer services generally, plus a wide array of information services. U.S. and other non-EU firms are required to register in one country but pay the VAT at the rate applicable to each customer's country. In contrast, EU firms pay tax at the single rate of the country in which they are located.

EU taxation of digital transactions raises several policy issues for the United States. These include the taxation of digital commerce, unequal taxation of EU versus non-EU firms, high tax compliance costs, EU competition with the Organization for Economic Cooperation and Development's (OECD's) multilateral discussions of the taxation of e-commerce, and the possibility of a complaint to the WTO. The issue of requiring a foreign firm to collect tax on sales at multiple rates depending on the customer's country of residence is similar to the domestic issue, raised in connection with the Internet tax moratorium, of possibly requiring U.S. sellers to collect tax on interstate sales based on the tax in the customer's state of residence. (For further discussion, see CRS Report RS21596, *EU Tax on Digitally Delivered E-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 in 1995 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. 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. (For further discussion, see CRS Report RS20823, *The EU-US Safe Harbor Agreement on Personal Data Privacy.*)

Fostering Cooperative Competition Policies

In recent years the EU and the United States have sparred over competition policies. Known as anti-trust policy in the United States, these laws provide remedies to deal with a range of anti-competitive practices, including price fixing and other cartel arrangements, abuses of a dominant position or monopolization, mergers that limit competition, and agreements between suppliers that foreclose markets to new competitors.

While regulators on both sides share much information and seek to collaborate in ways that provide for consistent policies, two high-profile cases have raised questions about the need to improve cooperation. These cases are the European Commission's July 2001 decision to block the merger of General Electric and Honeywell and the Commission's March 24, 2004 decision to impose remedies and fines on Microsoft for alleged violation of European competition laws.

GE-Honeywell Case

As M&A activity has accelerated in the 1990s 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 2001 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.

Microsoft Case

After a five-year investigation of Microsoft Corporation's alleged leveraging of its near monopoly in the market for personal computer operating systems and for media players, the European Commission on March 24, 2004, fined Microsoft $612 million and ordered the company to disclose to its competitors the interfaces required for their products to "talk" with the Windows operation system. In addition, Microsoft is required to offer a version of its Windows operating system without Windows Media Player to PC manufacturers or when selling directly to end users.

The order effectively puts Microsoft on notice that future attempts to add features to Windows would be challenged in Europe if the additions put rival products at competitive disadvantage. The ruling is intended to ensure that "anyone who develops new software has a fair opportunity to compete in the marketplace," EU competition commissioner Mario Monti said in Brussels. Microsoft called the EU's decision "unwarranted and ill-considered," and said it expected to appeal the order in European courts.

The penalties go well beyond the terms of a settlement Microsoft reached with the U.S. Justice Department and several states in 2001. A Justice Department official criticized the EU's decision to adopt separate mandates, and several members of Congress warned that the ruling could widen trade and diplomatic rifts between the U.S. and Europe.

R. Hewitt Pate, Chief of the Justice Department's Antitrust Division, criticized the approach taken by the EU in requiring code sharing as part of its remedy for protecting "competitors, not competition." Pate also expressed concern that the EU decision could "dull lawful innovation ... and hurt consumers."

The reaction from Congress was mixed. Senator Herb Kohl, ranking minority member of the Senate Judiciary Committee's Antitrust, Competition Policy and Consumer Rights Subcommittee, stated that "much of the EU's decision" reflects his subcommittee's recommendation to the Justice Department when it settled its case against Microsoft. House Judiciary Committee Chairman F. James Sensenbrenner said the decision "raises important questions concerning the extraterritorial application of foreign antitrust law." And Senate Majority Leader Bill Frist stated that "I now fear that the U.S. and EU are heading toward a new trade war and the Commission's ruling against Microsoft is the first shot."

A number of antitrust lawyers argued that the decision highlights fundamental differences between the U.S. and EU in dealing with monopoly abuse. Efforts to harmonize the U.S. approach to antitrust with authorities in the EU are, thus, likely to continue.

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 also 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.

Subsequent negotiations proceeded at a slow pace and eventually broke down at the Cancun Ministerial Conference held September 10-14, 2003. At this meeting, trade negotiators were unable to reach agreement on the course of the multilateral trade negotiations. The immediate cause of the collapse was disagreement over launching negotiations on investment and competition, but agriculture and industrial market access were also sources of contention.

After the collapse of the Ministerial Conference, Brussels and Washington have explored different ways in getting the Doha Round restarted. On December 2, 2003, the European Commission approved a white paper on reviving the Doha talks. USTR Robert B. Zoellick outlined his proposals for moving the round forward in a letter to trade ministers dated January 11, 2004. On April 16, 2004, the EU withdrew its previous demand that member countries of the WTO agree to negotiate new rules on the so-called Singapore issues of investment, government procurement, competition policy, and trade facilitation. And on May 16, 2004, the EU announced that it is prepared to negotiate the elimination of all export subsidies as part of an effort to inject new momentum in talks.

The EU concessions, in turn, helped trade ministers attending a "mini-ministerial" in Paris secure a mandate to reach agreement by mid-July on the development of "frameworks" for the negotiations. In WTO parlance, a framework has come to mean a broader, more general guidance on the nature of the concessions made by the participants. Both the EU and

the United States have underscored the necessity to agree on frameworks by July 2004, otherwise electoral concerns in the United States, and the enlargement process in the EU, could delay further progress until 2005.

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 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.

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CRS Report RL31860. *U.S. - European Union Disputes in the World Trade Organization*, by Raymond J. Ahearn and Jeanne Grimmett.

CRS Report RS21372. *The European Union: Questions and Answers,* by Kristin Archik.

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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.

The Center for Transatlantic Relations. *Drifting Apart of Growing Together? The Primacy of the Transatlantic Economy,* Johns Hopkins School of Advanced International Studies, 2003, 35 p.