

# 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. At the same time, a confluence of old and new trade disputes, entailing U.S. retaliation and EU threats of counter-retaliation have increased trade tensions in recent years. A final ruling issued January 14, 2002 by the World Trade Organization (WTO) against a U.S. export tax benefit figures prominently in current trade disputes, along with the EU's failure to approve pending applications for new biotechnology crops and the possible imposition of U.S. steel restraints in March.

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

In order to build a smoother relationship, Brussels and Washington may have to resolve a number of these disputes and avoid an outbreak of new disputes this year. The

agreement to launch a new round of multilateral trade negotiations at the WTO trade ministerial held last November in Doha, Qatar has facilitated this effort. An increased desire for U.S.-EU cooperation in the wake of last September's terrorist attacks could also spill over to help moderate trade frictions.

But the two sides must now deal with the fall-out from the final WTO ruling that the U.S. offshore Foreign Sales Corporation (FSC) scheme is an illegal subsidy. Europe has until the end of April, 2002 to decide whether to impose retaliatory tariffs against what could be several billions of dollars of U.S. exports or to reach a negotiated settlement. This dispute, combined with continuing controversies over a 1916 U.S. dumping law and an upcoming February decision by the Bush Administration on imposing tariffs to protect U.S. steel producers, has the potential for re-igniting transatlantic trade tensions.

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

## MOST RECENT DEVELOPMENTS

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

*The European Union and Japan announced on March 1, 2002 that they will give the United States until June 30 to comply with a WTO dispute panel ruling against its 1916 Antidumping Act.*

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

*The European Union and Japan on January 8, 2002 called for a special meeting of the WTO Dispute Settlement Body to seek approval for trade retaliatory measures in disputes involving a 1916 U.S. Antidumping Law and an exemption from copyright fees for music played in public establishments.*

*The EU and United States agreed on December 18, 2002 on how to handle a trade dispute the United States lost in a WTO case involving licensing of music played in public establishments. Under the agreement, the Bush Administration agreed to seek the authorization and funding from Congress to contribute \$3.3 million to a European fund to benefit European musicians. But the two sides failed to reach agreement on a dispute involving U.S. implementation of an adverse WTO ruling against its 1916 Antidumping Act.*

## 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, 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.

At the same time, a confluence of old and new trade disputes, entailing U.S. retaliation against EU trade and EU threats of counter-retaliation, increased trade tensions in 1999 and 2000. Last year the EU's rejection of a merger between General Electric and Honeywell and a World Trade Organization (WTO) was a prominent new dispute. And in January 2002, a combination of disputes involving the U.S. offshore tax subsidy, the 1916 U.S. Antidumping Law, and the possibility of the imposition of higher U.S. steel tariffs, have further increased trans-Atlantic trade tensions.

In order to build a smoother relationship, the two trading powers may have to resolve a number of these disputes and avoid an outbreak of new disputes this year. The agreement reached to launch a new round of multilateral trade negotiations at the November WTO trade ministerial in Doha, Qatar has facilitated this effort. Congress in its response to both EU practices and Bush Administration initiatives will play a key role in managing the U.S.-EU economic relationship.

## **Closer Economic Ties**

The United States and the European Union share the largest bilateral trade and investment relationship in the world. Annual two-way flows of goods, services, and foreign investment transactions now exceed \$1 trillion. Viewed in terms of goods and services, the United States and EU are each other's largest trading partners. Each purchases about one-fifth of the other's exports of goods and about one-third of the other's exports of services. And much of the trade in goods is increasingly in high-technology and sophisticated product areas where incomes and tastes are the primary determinants of market success.

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

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

## **Growing Strains**

Given the huge volume of commercial interactions, it is commonly pointed out that trade disputes are quite natural and perhaps inevitable. While the vast majority of two-way trade and investment is unaffected by disputes, a small fraction (often estimated at 1 percent) 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, the U.S. Ambassador to the EU, said in a January 23, 2001 speech that the inability of our two sides "to resolve our list of disputes, which are growing in both number and severity, is beginning to overshadow the rest of the relationship." Moreover, some of the efforts at

dispute resolution have led to escalation and “tit-for-tat” retaliation with the potential to harm the multilateral trading system.

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

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

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

## **Current Trade Agenda**

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

At the top of the list of bilateral disputes is the FSC case. On the basis of the January 14, 2002 WTO ruling that the U.S. FSC offshore tax provision is a prohibited subsidy, the EU has claimed it is entitled to just over \$4 billion in “countermeasures.” The U.S. has argued the figure should be \$956 million, with the final amount to be determined by a WTO arbitrator in late April. EU retaliation on U.S. trade anywhere within the magnitude of the range of these two figures could risk the break-out of a trade war, with significant damage to a fragile world economy. While the EU has clearly stated it wants compliance and not retaliation, it is unclear whether the Administration and Congress could achieve compliance in a timely fashion. The FSC dispute is joined by disputes over the 1916 U.S. Antidumping Act, an upcoming U.S. decision due March 6 on whether to provide protection to the domestic steel

industry, and continuing EU failure to approved pending applications for new biotechnology crops.

## Major Issues and Policy Challenges

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

### Avoiding A “Big Ticket” Trade Dispute

Perhaps the most serious trade dispute that currently clouds the bilateral relationship deals with tax breaks for U.S. exporters. If not managed properly, it could lead to a massive disruption of trade and a major increase in political tensions.

**U.S. Tax Benefits for Exports.**<sup>1</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.

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.

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<sup>1</sup> Prepared by David Brumbaugh, Specialist in Public Finance, and Jane G. Gravelle, Senior Specialist in Economic Policy, Government and Finance Division

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

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

The Bush Administration opted to appeal the WTO ruling. But the appeal was rejected by the WTO on January 14, 2002, thereby leaving both sides with difficult choices. The options for a settlement include U.S. efforts to enact further changes in its tax laws to conform to WTO rules; U.S. offers of compensation to the EU for trade damages; U.S. acceptance of EU trade retaliation; or efforts to settle the dispute in the context of the Doha Round of trade negotiations consistent with the objective of clarifying the Antidumping and Countervailing Duty Agreements. While the last option perhaps is the most attractive, it raises the question of what concessions the EU and other countries might demand in return.. (For further discussion, see CRS Report RS20746, *Export Tax Benefits and the WTO*).

## **Resolving Longstanding Disputes**

The United States and EU are again engaged in disputes involving Airbus and steel. These long-running skirmishes involve efforts by both Brussels and Washington to craft policies that provide important producer interests with financial support and/or protection from import competition. Efforts to resolve both disputes are likely to continue throughout this year.

## **Airbus Production Subsidies<sup>2</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

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<sup>2</sup> Prepared by John W. Fischer, Specialist in Transportation, Resources, Science, and Industry Division.



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. In recent years, after two decades of trying, Airbus has come close to achieving parity in sales with Boeing.

The basic premise of the dispute between the U.S. and EU is whether, as U.S. trade policymakers contend, Airbus is a successful participant in the market for large commercial jet aircraft not because it makes competitive products, which by all standards it does, but because it has received significant amounts of governmental subsidy and other assistance, without which it probably would not have been able to enter and participate in the market. Airbus, not surprisingly, does not accept the U.S. view of the reasons for its success.

At issue in the A380 development is at least \$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. The United States is concerned that the level of state-aid needed for this project could violate the 1992 Agreement on Government Support for Civil Aircraft between the United States and the EU, which limits direct assistance to one-third of development costs. The United States is also concerned that these loans will not be on commercial rates and terms, and that they might be forgiven if the A380 is a commercial failure.

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

**Steel Trade.**<sup>3</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.

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<sup>3</sup> Prepared by Stephen Cooney, Industry Analyst, Resources, Science, and Industry Division.

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 determined that U.S. producers of about 80 percent 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. This decision is due by March 6, 2002.

European Union officials have indicated they would challenge any possible U.S. steel restrictions as violations of Article 2.1 of the WTO Safeguards Agreement. Reportedly, the three main points that could be raised are the ITC’s methodology in defining product categories, the period used by the ITC in evaluating whether domestic producers had been injured, and misapplication of the injury standard. (For more discussion, see CRS Electronic Briefing Book on Trade, [<http://www.congress.gov/brbk/html/ebtra1.shtml>], *Steel: Trade and Industry Issues*).

## **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. The longstanding beef hormone dispute can be viewed as a sub-set of the biotechnology controversy. 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 engineered (GE) crops and food products that contain them pose a potential threat to, and in some cases have already disrupted, U.S. agricultural trade. Underlying the conflicts are pronounced differences between the United States and EU about GE products and their potential health and environmental effects.

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

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

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

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

**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

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

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 exports from mostly France, Germany, Italy, and Denmark, countries deemed the biggest supporters of the ban.

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

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

In pursuing compensation talks, the Bush Administration is faced with a divided industry position. The American Meat Institute and the American Farm Bureau prefer carousel retaliation to settle the dispute while the American Cattlemen’s Beef Association supports efforts to gain increased access for non-hormone treated beef in exchange for dropping the retaliatory tariff on EU exports. (For further discussion, see CRS Report RS20142, *The European Union’s Ban on Hormone-Treated Meat*).

**E-Commerce and Data Privacy.** E-commerce - the purchase and delivery of products and services on-line - largely operates in a free trade environment. The United States has pressed to extend a de facto WTO moratorium on taxing e-commerce indefinitely. The EU, however, proposes that rules on sales of products and services over the Internet be negotiated individually as new goods or services, a plan that U.S. negotiators believe would allow Europeans to regulate Internet content by accepting Internet services in some areas and not in others. The EU and its members rely on value-added taxes on sales for a major part of their revenues and cannot easily contemplate exempting a new growth area of the economy.

The EU is currently close to adopting a directive and a regulation on applying value-added-taxes (VAT) on digital goods and services. The Bush Administration on February 8, 2002 stated it has serious concerns about the proposed tax on the grounds that it may violate the WTO obligation to accord national treatment to foreign goods and services..

The related issue of consumer 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 join safe harbor, and Congress is moving toward an examination of privacy legislation that potentially could be based on standards quite different from the ones Europe applies. Moreover, the European Parliament in early July 2001 passed a resolution calling for a renegotiation of the accord because it failed to adequately protect consumer privacy. (For further discussion, see CRS Report RS20823, *The EU-US Safe Harbor Agreement on Personal Data Privacy*).

## **Fostering a Receptive Climate for Mergers and Acquisitions**

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

### **Enhanced Antitrust Cooperation**

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

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

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

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

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

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

## **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, the EU eventually yielded to U.S. demands for a strong negotiating mandate to reduce agricultural exports. In return, U.S. negotiators supported EU efforts for negotiations on the environment, investment, and competition policy. Absent these balancing efforts, neither side would have been able to accept or promote the Doha agreement.

## **Accommodating Foreign Policy Sanctions That Have an Impact on Trade**

U.S. legislation that requires the imposition of economic sanctions for foreign policy reasons has been a major concern of the EU. While the EU often shares many of the foreign policy goals of the United States that are addressed legislatively, it has opposed the extraterritorial provisions of

certain pieces of U.S. legislation that seek to unilaterally regulate or control trade and investment activities conducted by foreign companies outside the United States. Most persistent EU complaints have been directed at the Cuban Liberty and Democratic Solidarity Act of 1996 (so-called Helms-Burton Act) and the Iran and Libya Sanctions Act (ILSA), which threatens the extraterritorial imposition of U.S. sanctions against European firms doing business in Cuba, Iran, and Libya.

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

EU Commissioner for External Affairs Christopher Patten called on the Bush Administration to endorse the 1998 understanding at a March 6, 2001 press conference. President Bush, in turn, on July 16, 2001 waived Title III of Helms-Burton for six months, and called on the EU and the international community to work with the United States for free speech, free elections, and respect for human rights in Cuba. Concerning ILSA, the House and Senate both passed bills (H.R. 1954, S. 1218) extending ILSA for an additional five years. H.R. 1954, also provides for termination of the bill with the passage of a joint resolution of the Congress. (For further information, see CRS Report RS20871, *The Iran-Libya Sanction Act (ILSA)*, by Kenneth Katzman.

## LEGISLATION

In the 107<sup>th</sup> Congress, there has been no legislation introduced to date that specifically addresses U.S.-EU trade relations. However, legislation has been introduced on the disparate matters of biotechnology, steel, and renewal of the Iran and Libya Sanctions Act – all of which could affect trans-Atlantic ties. These bills are noted below.

### **H.R. 115 (Holt)**

A bill to provide for a program of public education about biotechnology in food production.



**H.R. 713 (Tierney)**

A bill that requires the Secretary of Agriculture to conduct, through the National Academy of Sciences, a report on the safety and monitoring of GE foods.

**H.R. 808 (Visclosky)**

A bill to require the President to establish import quotas on steel products for five years, with monthly imports not to exceed the average of the three-year period leading up to the mid-1997 import surge.

**H.R. 1954 (Gilman)**

A bill to extend the Iran and Libya Sanctions Act of 1996 until 2006. Reported out of the House International Relations Committee on June 20, 2001 by a vote of 41-3. Passed the House July 26 by a vote of 409 to 6.

**S. 994 (Schumer)**

A bill to amend the Iran and Libya Sanctions Act of 1996 and to extend authorities under that Act. Passed the Senate on July 25 by a vote of 96 to 2.

## 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.

### Other Reports

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