

# CRS Issue Brief for Congress

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

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

### SUMMARY

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

Given a huge level of commercial interactions, trade tensions and disputes are not unexpected. In the past, U.S.-EU trade relations have witnessed periodic episodes of rising trade tensions and even threats of a trade war, only to be followed by successful efforts at dispute settlement.

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.

The two sides face difficult challenges in keeping the relationship on an even keel in 2006. A number of bilateral trade disputes have been carried over from 2005 and are expected to be considered by the World Trade Organization (WTO). These include disputes on production subsidies for aircraft manufacturers, the EU's treatment of bio-engineered foods, compliance in the long-running battle over tax breaks for U.S. exporters, and the continuing ban on beef treated with growth hormones. In addition, critical U.S.-EU differ-

ences, particularly over agriculture, now complicate and threaten progress in the ongoing Doha Round of world trade negotiations.

The biggest dispute in terms of the amount of trade involved relates to allegations that each side provides their civil aircraft producers, Airbus and Boeing, with illegal production subsidies. Both the EU and U.S. filed formal complaints with the WTO in May 2005 to this effect, and two separate WTO panels are scheduled to begin hearing the cases this year. However, panel rulings in these cases are not expected to be handed down until early 2007, thereby giving the United States and the EU ample opportunity to try to resolve the dispute bilaterally.

On a second dispute, the EU may have to decide this spring whether to reimpose sanctions on U.S. exports in the ongoing Foreign Sales Corporation (FSC)-extraterritorial income (ETI) export subsidy dispute. Congress thought it had brought U.S. law into conformity with U.S. WTO obligations when it repealed the FSC-ETI as a provision of the American Jobs Creation Act of 2004. But an EU challenge to several transitional provisions of the new law was upheld by the WTO, thereby setting the stage for a possible reimposition of sanctions this spring.

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 EU on March 14, 2006, informed the WTO that it would reimpose sanctions against U.S. imports in two months if the U.S. does not completely eliminate FSC export tax benefits that continue through 2006.

U.S. and EU trade officials announced on March 2, 2006, agreement on a formula for reducing industrial tariffs in the Doha round of multilateral negotiations.

The WTO's Appellate Body on February 13, 2006, upheld a ruling which determined that the United States failed to fully implement an earlier decision striking down tax breaks for U.S. exporting firms.

A WTO dispute panel issued a preliminary ruling February 7, 2006, supporting several key U.S. claims against the European Union's de facto moratorium on the approval of bio-engineered crops.

European Trade Commissioner Peter Mandelson stated on January 16, 2006, that he is prepared to accept failure of the Doha Round rather than accept a deal that offers no benefits to Europe.

The European Commission on January 4, 2006, presented to member states a new regulation to amend its system for protecting products under geographical names in response to a WTO panel decision. The panel determined that two aspects of the current system for protecting products such as *Champagne or Roquefort* were not consistent with the EU's obligation to treat trading partners no less favorably than its own nationals.

The U.S. and EU announced agreement on November 30, 2005, on a package of trade benefits designed to compensate the United States for tariff increases put in place by the EU following its enlargement to include 10 new member states in May 2004.

The WTO on October 17, 2005, appointed panelists to consider cases brought by the United States and EU against each others' alleged subsidies to their commercial aircraft manufacturers.

## 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 occurred again last year with high-profile disputes involving tax breaks for U.S. exporters and production subsidies for the commercial aircraft sector.

The two sides still face difficult challenges in the months ahead in keeping the relationship on an even keel. A number of bilateral trade disputes have been carried over from 2005 and are expected to be considered by the WTO dispute settlement bodies. These include disputes on production subsidies for aircraft manufacturers, the EU's treatment of bio-engineered food, compliance in the long-running battle over tax breaks for U.S. exporters, and the continuing EU ban on beef treated with growth hormones. In addition, critical U.S.-EU differences, particularly over agriculture, now complicate and threaten progress in the ongoing Doha Round of WTO negotiations.

## **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 \$1.3 trillion in 2004. 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 455 million citizens and a gross domestic product of about \$10.3 trillion (compared to a U.S. population of 289 million and a GDP of \$10.6 trillion) in 2003, 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 5-6 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 last 5-6 years, however, trade relations are being strained by the nature and significance of the disputes. Former 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*, by Raymond J. Ahearn.)

The United States and European Union currently 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 alleged government subsidies for Boeing and Airbus, the Byrd Amendment, and the EU ban on imports of genetically modified organisms (GMOs) are at the top of the list of bilateral challenges.

## **Major Issues and Policy Challenges**

Major U.S.-EU trade and investment issues and policy challenges can be grouped into five different categories: (1) complying with WTO rulings; (2) resolving 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

Some of the more 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.** In the latest chapter in a long-running U.S.-EU dispute over tax breaks for U.S. exporters — the so-called Foreign Sales Corporation (FSC)-extraterritorial income (ETI) provisions — the World Trade Organization’s Appellate Body ruled on February 13, 2006, that vestiges of these tax breaks are illegal. FSCs are subsidiaries of U.S. companies that conduct export sales on the behalf of their parents and the ETI is a successor tax regime. The FSC law initially was found to be inconsistent with U.S. WTO obligations in early 2000. Following the ruling, Congress passed the replacement ETI tax provision, but this law was also found inconsistent with WTO obligations in 2002. Subsequently, the WTO authorized the EU to retaliate in the absence of U.S. compliance, and the EU began imposing escalating retaliatory duties (starting at 5%) on \$4 billion of U.S. exports on March 1, 2004. After reaching 14% in December 2004, these sanctions were lifted in January 2005 subsequent to congressional repeal of the FSC-ETI provisions in the American Jobs Creation Act (P.L. 108-357) of October 2004. But the WTO ruling of February 13, 2006, determined that the act perpetuated the illegal subsidies with a two-year phase-out of the tax breaks and a grandfather clause covering exporters that had sales contracts dated before September 17, 2003.

In announcing the EU’s decision to reimpose sanctions, Peter Mandelson, the EU’s top trade official, said that “the EU will not accept a system of tax benefits which give U.S. exporters, including Boeing, unfair advantage against their European competitors.” Absent any additional U.S. legislation, the EU can be expected to reimpose sanctions on U.S. exports by May 13, 2006. EU spokesmen have indicated that a 14% tariff will be imposed on \$2.4 billion of U.S. exports.

U.S. reaction to the EU’s challenge of the new tax law and decision to reimpose sanctions has been almost uniformly negative. An official for the Office of the U.S. Trade Representative stated that “it is harmful for the EU to needlessly prolong this matter in the face of Congress’s good faith action.” Senate Finance Committee Chairman Charles Grassley stated that he remains frustrated and troubled by the actions of the EU. (For further discussion, see CRS Report RS20746, *Export Tax Benefits and the WTO: The Extraterritorial Income Exclusion and Foreign Sales Corporations*, by David L. Brumbaugh.)

**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 seven other parties successfully challenged the statute in the WTO on the grounds that the Byrd Amendment constitutes a “non-permissible specific action against dumping or a subsidy” contrary to various WTO agreements. Because the United States did not comply with the ruling by the arbitrated

deadline of December 27, 2003, the eight complaining members requested authorization from the WTO in January 2004 to impose retaliatory measures. A decision by a WTO arbitrator on the amount of retaliation U.S. trading partners can impose was handed down on August 31, 2004. The arbitrator determined that each of the eight complainants could impose countermeasures on an annual basis in an amount equal to 72% of the CDSO disbursements for the most recent year in which U.S. data are available.

Canada and the EU began retaliating on May 2, 2005, by placing a 15% additional duty on selected U.S. exports. Mexico imposed higher tariffs on U.S. milk products, wine, and chewing gum as of August 18, 2005, and Japan placed an additional tariff of 15% on 15 steel and industrial products as of September 1.

Despite strong congressional support for the measure in both chambers, a provision repealing the CDSOA was included in the conference report to S. 1932, the Deficit Reduction Act of 2005, and approved in February 2006. The language in the provision, however, would allow CDSOA payments on all goods that enter the United States to continue through October 1, 2007. As a result, the EU, Canada, and Mexico have indicated their intention to keep the sanctions on U.S. imports in place as long as the disbursements continue.

## 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. President Bush in an August 13, 2004 speech raised the stakes of the Airbus-Boeing dispute by stating that Airbus production subsidies are unfair. In October 2004, this long simmering dispute reignited when both sides took their complaints to the WTO. Tensions were somewhat diffused by a January 11, 2005 agreement to try to reconcile differences through a three-month period of bilateral negotiations. But negotiations stalled in April and the two sides filed complaints in the WTO over their respective government's alleged subsidies, thus creating the largest trade dispute in value terms ever considered by the WTO. The beef hormone dispute also heated up when the EU in November 2004 took the first steps to challenge in the WTO the sanctions the United States and Canada are imposing on EU exports.

**Airbus-Boeing Subsidy Tensions.**<sup>1</sup> The United States and the EC have now each filed complaints with the World Trade Organization (WTO), thus creating a major trade confrontation between these two trade superpowers. At the same time, U.S. and EU trade officials stated on June 17, 2004, that they would still search for a negotiated settlement of this aircraft subsidy dispute between Boeing and Airbus. However, on July 20, 2005, the WTO agreed to establish two dispute settlement panels to begin investigating the competing U.S. and EU complaints. Two panels were established on October 17, 2005 (one handling the U.S. charges against Airbus and the other handling the EU's counterclaims against Boeing), and both panels are scheduled to begin hearing the cases this year. Beginning this March, the two sides will begin filing and rebuttal submissions, providing the first public

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<sup>1</sup> Prepared by John W. Fischer, Specialist in Transportation, Resources, Science, and Industry Division.

glimpse into the arguments that will be made and evidence that will be presented. However, panel rulings are not expected to be handed down until early 2007. Whether the WTO litigation provides an incentive for the United States and the EU to resolve the dispute bilaterally remains to be seen.

This dispute had its beginnings on October 6, 2004, when the United States requested consultations with relevant parties pursuant to the World Trade Organization's (WTO) Understanding on Rules and Procedures Governing the Settlement of Disputes. At the same time the United States terminated a 1992 agreement between itself and the European Communities (EC) on Government Support for Civil Aircraft. Later in the same day, the EC, acting on behalf of itself, and the member states filed a separate request for consultations under the WTO dispute resolution process. Separately, the EC rejected the U.S. termination of the 1992 agreement.

In the 13 years since the 1992 Agreement was signed, the long-standing competitive relationship between the two major producers of large commercial aircraft has changed. Airbus, which was the number two producer for most of the 1990s, now leads Boeing in both new annual aircraft deliveries and orders. Boeing, although a strong competitor in this market, has experienced a number of high profile problems, most recently with its now on hold plan to sell/lease tankers to the Air Force.

Much of the ongoing discussion about the Airbus/Boeing relationship stems from Airbus's December 2000 launch of a program to construct the world's largest commercial passenger aircraft, the Airbus A380. Many observers believed then, that the A380 action could reopen a long-standing trade controversy between the United States and Europe about alleged subsidization of commercial aircraft projects that compete directly with non-subsidized U.S. products. It now appears that these concerns have come to fruition.

The market for large commercial aircraft (jet aircraft with 100 or more seats) 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, the firm is now owned by just two firms, EADS and BAE Systems. Airbus itself is now a public firm operating under the Airbus name (also known as Airbus SAS).

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 the U.S. trade policymakers contend, Airbus is a successful participant in the market for large commercial jet aircraft not because it makes good products, which by all standards it does, but because it has received significant amounts of governmental subsidy and other assistance, without which it is unlikely to have been able to enter and participate in the market.

The source of most recent controversy over subsidies, the Airbus A380, is being offered in several passenger versions seating between 500 and 800 passengers, and as a freighter. The project is believed to have cost about \$13 billion, which includes some significant cost overruns identified by Airbus earlier this year. Airbus expects that its member firms will provide 60% of this sum, with the remaining 40% coming from subcontractors. State-aid from European governments are also a source of funding for Airbus member firms. State-aid

is limited to one-third of the project's total cost by a 1992 Agreement on Government Support for Civil Aircraft between the United States and the European Union (EU).

At issue in the A380 development is at least \$3.2 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 have likely been provided to subcontractors by other European nations. Also at issue are large dollar infrastructure improvements provided by state and local governments that directly benefitted the A380 project.

Shortly after the A380 project was announced, Boeing dropped its support of a competing new large aircraft. Boeing believes that the market for A380 size aircraft is limited. It has, therefore, settled on the concept of producing a new technology 250-seat aircraft, the 787, which is viewed as a replacement for 767 size aircraft. Boeing formally launched the program in 2004.

To construct this aircraft Boeing is proposing to greatly expand its use of non-U.S. subcontractors and non-traditional funding. For example, a Japanese group will provide approximately 35% of the funding for the project (\$1.6 billion). In return this group will produce a large portion of the aircraft's structure and the wings. Alenia of Italy is expected to provide \$600 million and produce the rear fuselage of the aircraft. In each of these instances, the subcontractor is expected to receive some form of financial assistance from their respective governments. The project is also expected to benefit from state and local tax and other incentives. Most notable among these is \$3.2 billion of such incentives from the state of Washington.

**The Boeing View.** Boeing has long contended that Airbus has benefitted greatly from direct assistance from the member states. It is Boeing's view that several of Airbus's aircraft projects, especially the A380, would not have been able to obtain financing in commercial markets because of their large risks. The view is that Airbus's corporate decision-making is largely influenced by the knowledge that the firm ultimately cannot fail financially and because a large portion of the risk is borne by European partner governments.

Since early 2004, Boeing's management has continuously raised the subsidy issue with the Bush Administration and with Congress. As it has become apparent that Airbus might launch a new aircraft project, the A350, in response to the 787, with launch aid from the member states, Boeing's concerns have increased.

**The Airbus View.** Airbus does not accept the U.S. view of the reasons for its success. Although admitting to, but not completely disclosing, prior levels 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 to its governmental sponsors over the last several years as proof of its long-term intent to operate in a market environment. Airbus also contends that its loans are, contrary to Boeing claims, at commercial rates. Airbus counters the U.S. argument that subsidies are the principal reason for Airbus's 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 787 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 the aforementioned publically announced subsidies from Washington state, and the large amount of government assistance by Japan and Italy to firms that will serve as major subcontractors on the aircraft.

On April 11, 2005, the Senate passed a concurrent resolution calling for the Bush Administration to move the Airbus-Boeing dispute to the WTO if the EC and/or its Member States provide launch aid for the Airbus A350 aircraft (S.Con.Res. 25). Although the resolution has no force in law, the 96-0 vote in favor of the resolution demonstrates a clear Senate consensus that the issue is important to national policy.

**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. Canada imposed \$9.4 million in sanctions.

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 was faced with a divided industry position. The American Meat Institute and the American Farm Bureau preferred carousel retaliation to settle the dispute while the American Cattlemen's Beef Association supported 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 oestradiol 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).

On November 8, 2004, the EU took an initial step in the WTO to challenge the U.S. and Canadian sanctions still in effect. According to the EU, its October 2003 actions making the ban provisional for five growth hormones complies with WTO rules, which means the U.S. and Canada are no longer entitled to retaliate against its exports. The U.S. and meat industry, however, argue that making a ban provisional for the long term does not meet WTO obligations. Nevertheless, in February 2005, the EU secured the establishment of a panel to determine whether the United States and Canada are in violation of WTO rules by maintaining punitive tariffs on a number of EU products in the dispute. A WTO dispute panel hearing on this issue was held on August 1, 2005, and a second hearing is scheduled to be held in March 2006. (For further discussion, see CRS Report RS20142, *The European Union's Ban on Hormone-Treated Meat*, by Charles E. Hanrahan.)

## **Dealing with Different Public Concerns Over New Technologies and New Industries**

The emergence of new technologies and new industries is at the heart of a growing number of disputes. Biotechnology as a new technology and e-commerce (and related data privacy concerns) as a new industry are emerging issues that have great potential for

generating increases in transatlantic welfare, as well as conflict. These issues tend to be quite politically sensitive because they affect consumer attitudes, as well as regulatory regimes.

**Bio-technology.**<sup>2</sup> Another dispute that is likely to reappear this year involves the EU's de facto moratorium on the approval of bio-engineered foods, also commonly referred to as products containing genetically modified organisms (GMOs). This long-running dispute goes back to October 1998 when the United States, Argentina, and Canada alleged that the EU was applying a moratorium of the approval of bio-engineered or GMO products without any scientific justification, blocking a number of marketing applications already in the pipeline. The three also accused Austria, France, Greece, and Italy of prohibiting the importation and marketing of GMO products, even though these products had already been approved for sale within the EU.

The WTO panel, which was established in August 2003, is expected to release a preliminary and confidential ruling on February 1, 2006. A final report is expected to be released in March 2006. This dispute is one of the longest in the history of the WTO. Some of the delay has resulted from the EU's insistence on the appointment of scientific experts to help the panel deal with technical issues.

In November 2005 the European Commission gave market approval for the use of a corn crop known as 1507 as animal feed, the fourth occasion the Commission has authorized the sale of a GMO produced in the EU since Brussels formally lifted its moratorium on GMO approvals in 2004. The moratorium was formally lifted after the EU adopted new labeling and traceability rules for bio-engineered foods, but 11 member states including France, Germany, Austria, and Belgium have continued to impose their own moratoriums on the approval of new GMOs. The European Commission has brought a case against the member states at the European Court of Justice over implementing the directives.

But the U.S. government has argued that the EU has continued to impose a moratorium on approval of GMOs in violation of the WTO Agreement on Sanitary and Phytosanitary (SPS) measures. The EU has argued that the SPS agreement only addresses measures to protect human, animal, or plant life or health, which does not cover all issues the EU says are raised by GMO applications. Some questions on GMO applications, the EU argues, deal with non-living components of the environment and cannot be found in violation of the SPS agreement.

**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.

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<sup>2</sup> Prepared by Charles E. Hanrahan, Senior Specialist in Agricultural Policy, Resources, Science, and Industry Division.

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*, by Martin A. Weiss and Nonna A. Noto.)

The related issue of data privacy rights has also been a source of some 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 export of personal information outside EU member states unless the privacy laws in the country to which the information is to be received are deemed "adequate" by the EU. The fact that this list of countries did not include the United States, combined with the need for U.S. companies to be able to move data from Europe to the United States, prompted the creation of the "Safe Harbor" agreement of 2000. This mechanism allows U.S. companies within the jurisdiction of the Federal Trade Commission to comply with the EU Directive if they enroll with the Commerce Department, publicize that they will comply with the safe harbor rules, and recertify their compliance annually. As of December 2005, 837 U.S. companies were certified to the safe harbor program. (For further discussion, see CRS Report RS20823, *The EU-US "Safe Harbor" Agreement on Personal Data Privacy*, by Martin A. Weiss.)

## **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.

On December 22, 2004, a senior European judge upheld the implementation of the March sanctions. The Court of First Instance said that Microsoft had failed to demonstrate that imposing Commission penalties might cause it serious and irreparable damage.

Microsoft says it would still prefer a negotiated settlement to a continuing legal challenge to the sanctions. Nevertheless, Microsoft is still in the process of appealing the decision. Most recently, on November 14, 2005, Microsoft confirmed that it is trying to persuade the U.S. Justice Department to participate in its appeal. A decision in the appeal could take up to two years.

## **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. Then-USTR Zoellick and then-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 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. Then-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 conclude on August 1, 2004, an agreement setting the broad policy framework for the Doha negotiations. The framework

agreement also pledges to substantially reduce domestic supports and significantly expand market access for farm products. Members also agreed to hold a ministerial meeting of the WTO in Hong Kong in December 2005.

At the Hong Kong meeting, Peter Mandelson, who replaced Lamy as EU Trade Commissioner in November 2004, and former Congressman Robert Portman, who replaced Zoellick as U.S. Trade Representative, had difficulty in finding common ground. The fact that U.S. and EU negotiating priorities in some key areas, particularly agriculture, differ in significant ways has made progress difficult. In agriculture, the EU has called on the U.S. to make concessions on cutting domestic agriculture subsidies in return for flexibility on its part in market access. But a number of member states, including France, are against the EU offering any new agriculture concessions even if other WTO members offer parallel concessions in other areas such as services or industrial market access. But the U.S. has made it clear that it will not make additional concessions on domestic subsidies without EU concessions on market access. Unless this gap can be narrowed, it may be difficult to move the Doha talks forward. The next ministerial meeting is scheduled for April 30, 2006.

## FOR ADDITIONAL READING

### **CRS Reports**

CRS Report RS21556. *Agricultural Biotechnology: The U.S.-EU Dispute*, by Barbara A. Johnson and Charles E. Hanrahan.

CRS Report RL30608. *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by William H. Cooper.

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

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