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European Union–U.S. Trade and Investment Relations: Key Issues

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European Union–U.S. Trade and Investment Relations: Key Issues

Summary

The United States and EU share a huge, dynamic, and mutually beneficial economic relationship. Not only are trade and investment ties between the two partners huge in absolute terms, but the EU share of U.S. global trade and investment flows has remained high and relatively constant over time, despite the rise of Asian trade and investment flows. These robust commercial ties provide consumers on both sides of the Atlantic with major benefits in terms of jobs and access to capital and new technologies.

Agreements between the two partners in the past have been critical to making the world trading system more open and efficient. At the same time, the commercial relationship is subject to a number of trade disputes and disagreements that potentially could have adverse political and economic repercussions.

Washington and Brussels currently are working to resolve a number of issues, including a dispute between the aerospace manufacturers, Airbus and Boeing, and conflicts over hormone-treated beef, bio-engineered food products, and protection of geographical indicators. The Airbus-Boeing dispute involves allegations of unfair subsidization while the other disputes are rooted in different U.S.-EU approaches to regulation, as well as social preferences. Simultaneously, the two sides have cooperated to liberalize the transatlantic air services market and are working on harmonizing and/or liberalizing financial markets. Competition agencies in the U.S. and EU are also moving towards substantial convergence in some areas of antitrust enforcement. A new institutional structure, the Transatlantic Economic Council (TEC), was established in 2007 to advance bilateral efforts to reduce regulatory and other barriers to trade.

Congress has taken a strong interest in many of these issues. By both proposing and passing legislation, Congress has supported the efforts of U.S. industrial and agricultural interests to gain better access to EU markets. Congress has pressured the executive branch to take a harder line against the EU in resolving some disputes, but has also cooperated with the Administration in crafting compromise solutions. Primarily through oversight in the second session of the 110th Congress, many Members of Congress can be expected to support efforts to resolve existing disputes and to maintain an equitable sharing of the costs and benefits of the commercial relationship with the EU.

This report starts with background information and data on the commercial relationship and then discusses selective issues associated with trade in agricultural products, trade in services, and foreign direct investment. A concluding section assesses prospects for future cooperation and conflict. The report will be updated as events warrant.

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The United States and EU share the largest commercial relationship in the world. Not only are trade and investment ties between the two partners huge in absolute terms, but the EU share of U.S. global trade and investment flows has remained high and relatively constant over time, despite the rise of Asian trade and investment flows. These robust U.S.- EU commercial ties are mutually beneficial and provide consumers on both sides of the Atlantic with major benefits in terms of jobs and access to capital and new technologies.

Given the high level of commercial interactions, trade tensions and disputes are not unexpected. In the past, U.S.-EU trade relations have experienced periodic episodes of rising trade tensions and conflicts, only to be followed by successful efforts at dispute settlement. Policymakers and many academics tend to maintain that the U.S. and EU always have more in common than in dispute, and like to point out that trade disputes usually affect a small fraction (often estimated at 1-2 percent) of the trade in goods and services.

Currently, Washington and Brussels are working to resolve a number of issues, including a dispute between the aerospace manufacturers, Airbus and Boeing, and conflicts over hormone-treated beef, bio-engineered food products, and protection of geographical indicators. The Airbus-Boeing dispute involves allegations of unfair subsidization while the other disputes are rooted in different U.S.-EU approaches to regulation, as well as social preferences. Simultaneously, the two sides have cooperated to liberalize the transatlantic air services market and are working to harmonize and/or liberalize financial markets. Agencies in the U.S. and EU are also moving towards substantial convergence in some areas of antitrust enforcement. A new institutional structure, the Transatlantic Economic Council (TEC), was established in 2007 to advance bilateral efforts to reduce regulatory and other barriers to trade.

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[1] This section was written by Raymond J. Ahearn, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

Many different committees have oversight responsibilities over various aspects of the U.S.- EU commercial relationship. On the House side, these include the Committees on Agriculture, Energy and Commerce, Financial Services, Foreign Affairs, Judiciary, Transportation and Infrastructure, and Ways and Means. On the Senate side, these include the Committees on Agriculture, Banking, Commerce, Science, and Transportation, Finance, Foreign Relations, and Judiciary. A number of resolutions and hearings can be expected to take place in the second session of the 110th Congress on some of the issues raised in this report.

This report starts with background information and data on the commercial relationship and then discusses selective issues associated with trade in agricultural products, trade in services, and foreign direct investment. A concluding section assesses prospects for future cooperation and conflict.

Background[2]

Trade and Investment Ties

The United States and the 27-member European Union (EU) share a huge, dynamic, and mutually beneficial economic partnership.[3] Not only is the EU-U.S. commercial relationship, what many call the transatlantic economy, 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 trade and financial system more open and efficient.[4]

The transatlantic economy dominates the world economy by its sheer size and prosperity. The combined population of the United States and EU now approaches 800 million people who generate a combined gross domestic product (GDP) of $26.8 trillion ($13.6 trillion in the EU and $13.2 trillion in the U.S.). This sum was equivalent to 56% of world production or GDP in 2006.[5]

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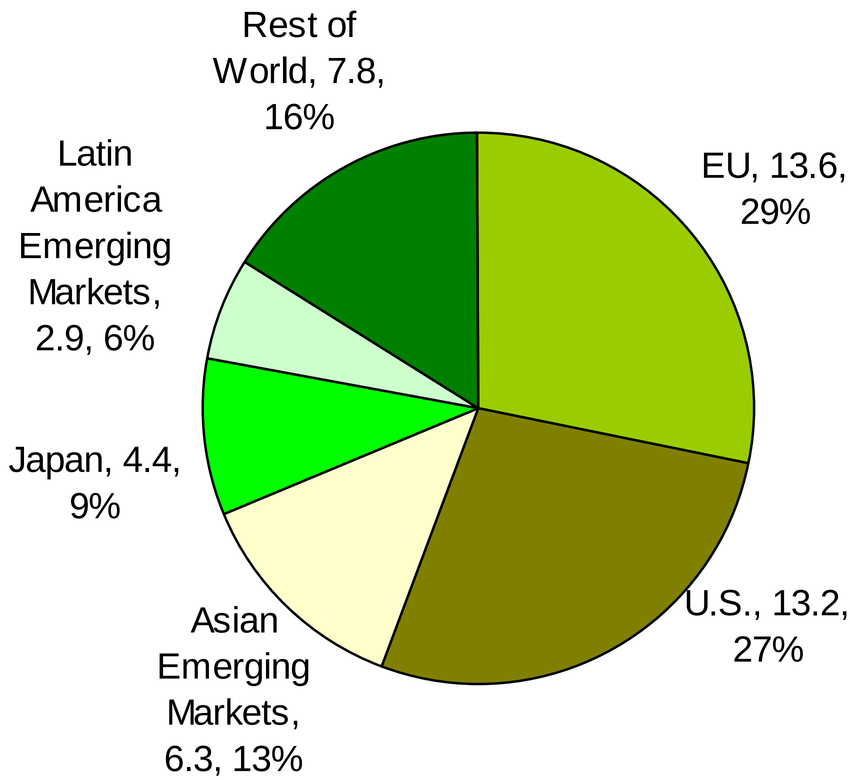
[2] This section was written by Raymond J. Ahearn, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

[3] For background information of the EU, see CRS Report RS21372, *The European Union: Questions and Answers,* by Kristin Archick. The members of the EU are as follows: Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

[4] This has included cooperation in completing many different multilateral trade liberalization rounds under the auspices of the General Agreement on Tariffs and Trade (GATT).

[5] International Monetary Fund, *Global Financial Stability,* September 2007.

Figure 1. World GDP in Trillions of U.S. Dollars, 2006

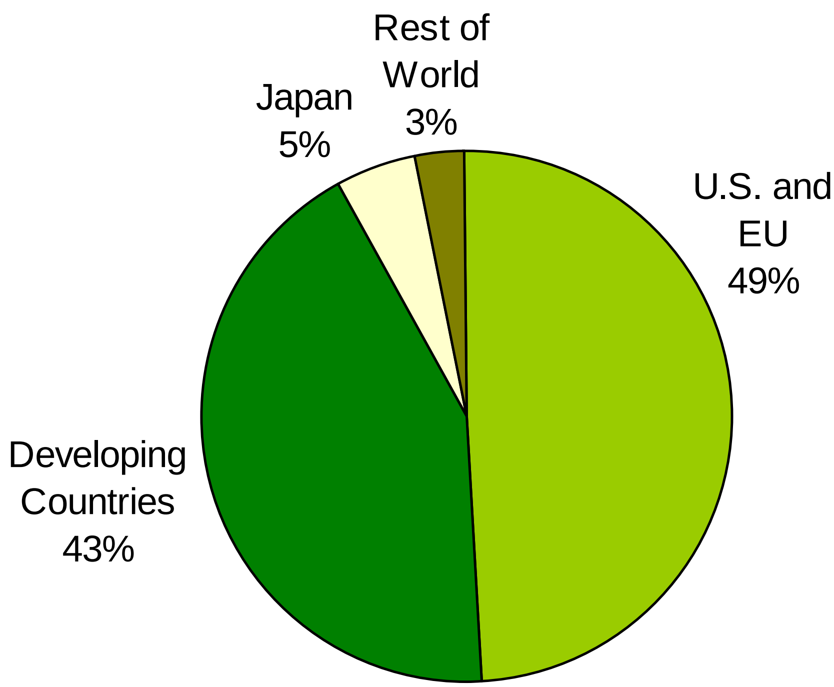


Source: IMF Global Financial Stability, Appendix Table 3

In addition, U.S. and EU international trade together accounts for just under 50% of world merchandise trade.[6] The combined weight of these two economic superpowers means that how the U.S. and EU manage their relationship and the difficult issues involving domestic regulations, competition policy, and foreign investment could well help determine how the rest of the world deals with similar issues.

[6] International Monetary Fund, *Directions of Trade Statistics Yearbook: 2007.*

Figure 2. World Exports and Imports of Goods, 2006



Source: IMF Direction of Trade Statistics

Per capita incomes, averaging around $28,000 in the EU and $34,000 in the U.S. are among the highest in the world. In addition to having among the world's wealthiest populations, the United States and EU are major producers of advanced technologies and services. Both partners also have sophisticated and integrated financial sectors which facilitate a huge volume of capital flows across the Atlantic and throughout the world. For example, of an estimated $152 trillion in outstanding world assets of bonds, equities, and bank deposits in 2006, $106 trillion or 70% were held in the United States and EU.[7]

The United States and EU are also parties to the largest bilateral commercial relationship in the world. As shown in **Table 1**, the value of the two-way flow of goods, services, and income receipts from investments totaled $1.3 trillion in 2006. This sum means that almost $4.0 billion flows between the two partners everyday on the current account, the most comprehensive measure of international transactions.[8]

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[7] *Global Financial Stability Report,* International Monetary Fund, September 2007, Statistical Appendix, Table 3.

[8] For more data and analysis, see CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by William H. Cooper.

Table 1. U.S. Current Account Balance with EU, 2006

(in billions of U.S. dollars)

Exports of Goods and Services	353.5
Imports of Goods and Services	459.4
Income Receipts	272.7
Income Payments	271.1
Unilateral Transfers (Net)	1.9
Total Current Account Flows	1,358.6

Source: CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, p. 7.

The United States and EU are each other's largest market for a host of goods and services, ranging from agricultural products to high tech goods and services. Large values of similar goods such as chemicals, transportation equipment, computers, and processed food as well as transportation and financial services are traded in record amounts. Within the EU, Germany, the United Kingdom, France, the Netherlands, and Italy are among the top 15 trading partners of the United States.[9]

Since 1993, the United States has been experiencing trade deficits with the EU. As shown in **Table 2**, these deficits peaked in 2005 at $123 billion. The trade deficit narrowed by 4.8% in 2006 to $117 billion and dropped even further in 2007.[10]

Table 2. U.S. Merchandise Trade Balance with the EU 27

(In billions of U.S. dollars)

Year	U.S. Exports	U.S. Imports	Balance
2002	147	233	-86
2003	156	254	-98
2004	173	283	-110
2005	187	310	-123
2006	215	332	-117
2007 (Jan-November)	229	326	-97

Source: Global Trade Atlas

[9] U.S. Census Bureau Foreign Trade Statistics. In 2006, Germany ranked #5, the United Kingdom #6, France, #8, the Netherlands #11, and Italy #14.

[10] Thru November 2007, the trade deficit was down 8.0% over the comparable period in 2006.

Macroeconomic factors, such as differences in economic growth rates and exchange rates, rather than trade barriers or other structural attributes, are generally thought to explain most of the fluctuation in the U.S.-EU bilateral deficit. For example, the reduction in the trade deficit in 2006 and again in 2007 is being driven by a decline in the value of the dollar by nearly 40% against the euro and 30% against the British pound since 2002.[11]

Complaints about the decline of the dollar and rise of the euro, however, are being voiced in Europe. While a stronger euro improves the purchasing power of consumers by making imports cheaper and by keeping a lid on inflation, some governments are worried that a stronger currency can stymie exports and exacerbate trade deficits. French and Italian government leaders have expressed more concerns along these lines than German officials, a divide that could reflect differences in the competitiveness of these key countries within the euro zone.[12]

Traditional trade barriers (tariffs and quotas) remain a problem in only a few selected areas such as agriculture, food, textiles and apparel. In these sectors, U.S. and EU tariffs still average between 10 and 20 percent ad valorem and help shield domestic producers from foreign competition.

Regulatory Cooperation

Instead of traditional barriers such as tariffs and quotas, non-tariff and regulatory barriers are increasingly recognized as the most significant trade and investment impediments to the creation of a more integrated transatlantic market. Prompted by this understanding, Germany's Chancellor Angela Merkel, upon assuming the rotating six-month Presidency of the EU in January 2007, advocated further liberalization of transatlantic trade and investment barriers by improving cooperation on reducing non-tariff and regulatory barriers to trade. The aim of such efforts is to reduce costs to businesses on both sides of the Atlantic, improve consumer welfare, and facilitate higher levels of economic growth.

Automotive safety standards are one example of how different regulations increase costs. For example, a U.S. citizen cannot go to Germany and purchase a BMW or Mercedes and import it directly into the United States because it does not meet U.S. safety standards. But if U.S. and German automakers had safety standards that were recognized by both the United States and EU, they could reduce their costs by not having to produce two different automobiles. The European Commission has estimated that further transatlantic liberalization of these kinds of regulatory barriers could lead to permanent gains of 3 to 3.5 percent in per capital gross domestic product on both sides of the Atlantic.

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[11] The fact that the EU share of the U.S. global trade deficit declined from 18% in 2002 and 2003 to 14% in both 2006 and 2007 is a further reflection of the impact that exchange rate changes are having on trade flows.

[12] *The Economist*, "Love the one you're with; Exchange rates," October 20, 2007.

There have been a number of previous attempts to reduce remaining non-tariff and regulatory barriers to trade. These have included the New Transatlantic Agenda (1995), the Positive Economic Agenda (2002), the Transatlantic Economic Partnership (2004), and the Transatlantic Economic Agenda (2005). While each of these initiatives has made some progress towards reducing regulatory burdens, both European and U.S. companies heavily engaged in the transatlantic marketplace argue that the results have not proved materially significant.

In a departure from these past efforts that relied substantially on voluntary and non-binding dialogues among regulators with some political endorsement, the Merkel initiative proposed creating an overarching framework to provide greater commitment on the part of political leaders and greater accountability on the part of regulators. According to *Business Europe*, the EU's main business trade association, the initiative would require legislators and officials to take into account how new laws and regulations affect the transatlantic marketplace.[13] Merkel's proposal also covered issues such as public procurement, intellectual property, energy and the environment, financial markets and security, and innovation.

Building on and borrowing from the Merkel initiative, the April 2007 U.S.-EU Summit adopted a *Framework for Advancing Transatlantic Economic Integration*. The framework affirmed the importance of further deepening transatlantic economic integration, particularly through efforts to reduce or harmonize regulatory barriers to international trade and investment. A new institutional structure, a Transatlantic Economic Council (TEC), was established to advance the process of regulatory cooperation and barrier reduction.

The TEC is headed on both sides by ministerial-level appointees with cabinet rank.[14] Given that the two leaders are cabinet-level appointees, the TEC is expected to have high-level political support that previous efforts at economic integration may have lacked. Such clout, it is argued, is needed to persuade domestic regulators to yield some of their authorities or to better cooperate with their counterparts across the Atlantic in harmonizing regulatory approaches.[15]

The mandate of the TEC is to accelerate on-going efforts to reduce or harmonize regulatory barriers, in part, by including broader participation of stakeholders, including legislators, in the discussions and cooperative meetings. In particular, the framework document calls upon the TEC to draw upon the heads of the "existing transatlantic dialogues" to provide input and guidance on priorities for pursuing transatlantic economic integration. The existing transatlantic dialogues include the

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[13] Position Paper on a Transatlantic Framework Agreement, Business Europe, March 1, 2007.

[14] To chair the TEC, the U.S. side named Alan Hubbard, Assistant to the President for Economic Policy and Director of the National Economic Council, and the EU appointed Gunter Verheugen, Vice President of the European Commission and Commissioner for Enterprise and Industry.

[15] For more information on the TEC, see Section IV in the U.S.-EU Framework for Advancing Transatlantic Economic Integration, April 2007, available at [http://www.whitehouse.gov/news/releases/2007/04/20070430-4.html].

Transatlantic Legislators' Dialogue (the U.S. Congress-European Parliament exchange), the Transatlantic Business Dialogue, and the Transatlantic Consumers Dialogue.

The first meeting of the TEC took place on November 9, 2007 in Washington. At this meeting a report, prepared jointly by the Office of Management and Budget and the Secretariat-General of the European Commission, recommended including costs of regulation to foreign businesses in the cost-benefit analysis of new regulations.[16] While business groups see this initiative as an opportunity to resolve and or avoid trade disputes embedded in different regulatory approaches, some consumer groups are wary of such efforts to harmonize regulatory activities. The Transatlantic Consumer Dialogue, for example, warned that U.S. cost-benefit analyses of new regulations routinely overstate the costs and underestimate the benefits of regulations, to the detriment of consumers.[17]

The difficulty of harmonizing regulatory activities or resolving disputes embedded in regulatory differences was also underscored at the TEC meeting by failure to resolve a long-standing dispute involving U.S. exports of poultry to the EU. The EU ban is based on health safety concerns regarding the use of several anti-microbial agents used by U.S. processing plants. But U.S. industry and officials say the health safety concerns are being used as disguised trade barriers – a concern that is echoed in other U.S.-EU trade disputes rooted in regulatory differences.[18]

Trade in Manufactured Goods

Overview[19]

The EU as a unit is the largest merchandise trading partner of the United States. In 2006, the EU accounted for $196 billion of total U.S. merchandise exports (or 20.7%). Manufactured goods such as aircraft, and machinery of various kinds, including computers, integrated circuits, and office machine parts accounted for over 90% of this total. Similarly, manufactured goods such as passenger cars, machinery of various types, computers and components, office machinery, and organic chemicals accounted for over 88% of the $304 billion in U.S. imports (17.85% of total imports) from the EU.[20]

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[16] The European Commission serves as a kind of executive branch for the EU. The EU is the legal entity with competence in the international trade and economic realm.

[17] *Inside U.S. Trade,* "Trans-Atlantic Talks on Harmonizing Rules to Ensure Transparency, OMB's Dudly Says," December 6, 2007.

[18] *Inside U.S. Trade,* "TEC Highlights EU Poultry Ban Resolution Next Year," November 16, 2007.

[19] This section was written by Raymond J. Ahearn, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

[20] CRS calculations based on data from Global Trade Atlas.

As shown in **Table 3**, a sizeable portion of U.S.-EU trade involves goods from the same industry, a phenomenon economists call intra-industry trade. This type of trade is particularly characteristic of large advanced economies that have similar resource endowments and levels of technology. Given that both the U.S. and EU produce goods under broadly similarly wage, safety, and environmental standards, each side concentrates on producing a narrower range of products at larger scale. By exploiting larger production runs of some sub-set of these goods, both sides are able to produce and trade at lower unit costs.

A significant attribute of intra-industry trade is that it tends not to generate the strong effects on the distribution of income that can occur when developed economies trade with less-developed economies. As a result, this kind of trade may prove less politically contentious due to broader sharing of the benefits garnered from rising productivity.[21]

Table 3: Top U.S.-EU Exports and Imports by 2-digit Commodity Classification, 2006

Top U.S. Exports to EU	Value (U.S. billions) and %	Top U.S Imports from the EU	Value (U.S. billions) and %
Machinery (non-electrical)	$40.5 (18.9%)	Machinery (non-electrical)	$53.0 (16.2%)
Optical and medical instruments	$21.8 (10.2%)	Vehicles	$41.0 (12.5%)
Electrical machinery	$21.6 (10.1%)	Pharmaceutical products	$28.0 (8.6%)
Pharmaceutical products	$14.6 (6.8%)	Organic chemicals	$26.4 (7.3%)
Organic chemicals	$11.5 (5.3%)	Electrical machinery	$18 (5.7%)
Totals	$110 (51.3%)		$166.4 (50.3%)

Source: CRS calculations based on Global Trade Atlas.

While the vast majority of the trade in manufactured goods is transacted without major controversy, disputes do arise. The most prominent current dispute involves Airbus and Boeing and the manufacture and sale of commercial aircraft. An overview of this dispute is presented below.

In addition, numerous other barriers to market access are flagged by industry on both sides of the Atlantic. U.S. exporters, on the one hand, identify various EU member state policies governing pharmaceuticals and health care products and a new chemicals regulation as distorting trade. EU exporters to the United States, on the

[21] CRS Report RL33944, *Trade Primer: Qs and As on Trade Concepts, Performance, and Policy*, by Raymond J Ahearn, et. al., pp. 4-5.

other hand, complain about technical regulations regarding consumer protection (including health and safety) and environmental protection, as well as additional requirements set by individual states. More detail on these complaints, as well as allegations of trade barriers affecting other sectors and industries, are contained in each side's annual trade barrier reports.[22]

Airbus-Boeing[23]

Claims and counter-claims concerning government support for the aviation industry have been a major source of friction in U.S.-EU relations over the past several decades. The disputes have focused primarily on EU member-state support for Airbus Industrie, now a part of Europe's largest aerospace firm, EADS (European Aeronautic Defense and Space Company). According to the Office of the U.S. Trade Representative (USTR), several European governments (France, U.K., Germany and Spain) have provided massive subsidies since 1967 to their aerospace firms to aid in the development, production, and marketing of the Airbus family of large civil aircraft. The U.S. has also accused the EU of providing other forms of support to gain an unfair advantage in this key sector, including equity infusions, debt forgiveness, debt rollovers, marketing assistance, and favored access to EU airports and airspace.[24]

For its part, the EU has long resisted U.S. charges and argued that for strategic and economic purposes it could not cede the entire passenger market to the Americans, particularly in the wake of the 1997 Boeing-McDonnell Douglas merger and the pressing need to maintain sufficient global competition. The Europeans have also counter-charged that their actions are justified because U.S. aircraft producers have benefitted from huge indirect governmental subsidies in the form of military and space contracts and government-sponsored aerospace research and development.[25]

The most recent round of this longstanding trade dispute stems from a May 30, 2005 WTO filing by the United States alleging that EU member states provided Airbus with illegal subsidies giving the firm an unfair advantage in the world market for large commercial jet aircraft. The following day the EC submitted its own request to the WTO claiming that Boeing had received illegal subsidies from the U.S. government. 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 have begun hearing the cases.

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[22] European Commission, United States Barriers to Trade and Investment, February 2007, and 2007 National Trade Estimate Report on Foreign Trade Barriers, Office of the United States Trade Representative.

[23] This section was written by John W. Fischer, Specialist in Transportation Policy, Resources, Science, and Industry Division.

[24] USTR National Trade Estimates Report: 2000, pp. 102-104.

[25] Burger, Bettina. "Transatlantic Economic Relations: Common Interests and Conflicts in High Technology and Industrial Policies," In *Transatlantic Relations in A Global Economy*, p. 110.

On September 26, 2007, the WTO dispute settlement panel heard oral arguments in the EU case (DS353) against the U.S. In the case, the EU claimed Boeing received about $24 billion in support in the form of "sham" contracts from the Department of Defense (DOD) and NASA, tax breaks from Illinois and Washington state, and bonds from Kansas. Furthermore, the EU charged that these subsidies and tax incentives cost Airbus $27 billion between 2004 and 2006 as the company either lost sales or had to sell its aircraft at lower prices.

U.S. trade officials rejected the EU claims that research contracts between Boeing and NASA or DOD are subsidies as defined by the WTO agreement on Subsidies and Countervailing Measures (ASCM). Rather than subsidies, the U.S. side argued that the contracts under question are research-for-pay arrangements in which Boeing gets paid for services rendered. During hearings on January 16 and 17, 2008, the panel asked the U.S. for more information to back its claim that NASA purchased $750 million in services from Boeing since 1992, not the $10 billion the EU is claiming.[26]

The EU case is in an earlier stage procedurally than the U.S. challenge to alleged Airbus subsidies (DS316), where an interim ruling may occur by the end of this year. The U.S. alleges that Airbus received $205 billion in illegal subsidies in the form of "launch aid" from the governments of Germany, United Kingdom, France, and Spain.

Much of the dispute stems from Airbus's December 2000 launch of a program to construct the world's largest commercial passenger aircraft, the Airbus A380. The A380 is being offered in several passenger versions seating between 500 and 800 passengers, and as a freighter. At the end of 2007, Airbus was listing 189 orders for the aircraft.[27] The project is believed to have cost about $18 billion, which includes some significant cost overruns. Airbus expects that its member firms will provide 60% of this sum, with the remaining 40% coming from subcontractors. State-aid from European governments is also a source of funding for Airbus member firms. State-aid is limited to one-third of the project's total cost by the 1992 Agreement on Government Support for Civil Aircraft between the United States and the EU (now repudiated by the United States, but not by the EU).

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.[28] The 787 is designed to provide point-to-point service on a wide array of possible international and domestic U.S. routes. The aircraft design incorporates features such as increased use of composite materials in structural elements and new engines, with

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[26] *Inside U.S. Trade,* "WTO Boeing Panel Probes U.S. on NASA Contracts, State Taxwes," February 1, 2008.

[27] [http://www.speednews.com/speednews_files/data/249.pdf]

[28] Boeing has rethought its position on the large aircraft market. On November 14, 2005 Boeing launched the 747-8, a new stretched derivative of the venerable 747. Boeing had 103 orders for the aircraft by year end 2007, many of which are for a freighter configuration of the aircraft.

the goal of producing an aircraft that is significantly more fuel efficient than existing aircraft types. Boeing formally launched the program in 2004 and obtained 56 firm orders during the remainder of 2004. By year-end 2007, the order book for the 787 had expanded dramatically to 817 aircraft.

To construct this aircraft Boeing has greatly expanded 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 (this will be the first time that a Boeing commercial product will use a non-U.S. built wing). 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. Other subcontractors are also taking large financial stakes in the new aircraft. 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. Many of these non-traditional funding arrangements are specifically cited by the EU in its WTO complaint as being illegal subsidies.

Whether the prospect of protracted WTO litigation provides an incentive for the United States and the EU to resolve the dispute bilaterally remains to be seen. To date the two sides have wrangled over a host of procedural issues, but have not been negotiating on a possible settlement to the dispute. In October 2007, Airbus Americas Chairman Allan McArtor publically spoke about the value of a negotiated settlement that would set the rules for subsidizing the development of large civil aircraft along the lines of the 1992 Civil Aircraft agreement. Some analysts believe that any Airbus negotiating effort along these lines may be driven by the needs of Airbus parent EADS to complete a corporate restructuring, and find launch aid and other capital to complete development of its new A350, which is designed to compete with the 787. In addition, there may be a view that Airbus has more to lose than Boeing from WTO rulings in the pending cases. Other analysts speculate that Airbus' weakened business condition brought on by the delivery delays of its jumbo A380 plane may also be a reason why it may be more inclined now to settle the case. On the other hand, Boeing officials continue to publically maintain that they are not interested in settling the case. Rather they express confidence in the strength of the U.S. WTO case which alleges that launch aid for Airbus is a prohibited subsidy under the ACSM.

Trade in Agricultural and Primary Products[29]

Overview

The United States and the EU-27, the world's leading producers and exporters of agricultural products, also are significant markets for each other's agricultural exports. The EU is the United States' fourth largest agricultural export market. In

[29] This section was written by Charles E. Hanrahan, Senior Specialist in Agricultural Policy, Resources, Science, and Industry Division.

FY2007, U.S. agricultural exports to the EU amounted to $8.0 billion according to the U.S. Department of Agriculture, while U.S. agricultural imports from the EU totaled just under $15.0 billion. Tree nuts (almonds, walnuts, pistachios, pecans, etc.) are the largest single component of U.S. agricultural exports to the EU, accounting for more than $1.4 billion in 2007. The next largest categories are soybeans, tobacco, and wine and beer. The largest commodity categories of U.S. agricultural imports from the EU are wine and beer (more than $4.8 billion in 2007), essential oils (e.g, peppermint or spearmint oils, that are widely used for flavoring or fragrances), cheese and other dairy products, and snack foods, including chocolate.

Among factors affecting U.S.-EU agricultural trade flows have been disputes over trade in meats from animals produced with growth-promoting hormones; differences in consumer attitudes and regulatory requirements for genetically modified organisms (GMOs) such as genetically modified varieties of soybeans and corn; and differences over legal protections accorded to geographical indications for agricultural products.

Meat Hormones

In a January 1998 ruling, the Appellate Body (AB) of the World Trade Organization (WTO), upheld an earlier panel ruling which found that the EU had violated the WTO's Agreement on the Application of Sanitary and Phytosanitary Measures (the SPS Agreement) by prohibiting imports of U.S. meats and other products derived from animals raised with growth-promoting hormones. The panel and the AB concurred that the EU had not conducted an assessment of the risks to consumers of eating hormone treated meat. The AB, however, left open the possibility that the EU could conduct another risk assessment. When the EU declined to comply with the WTO ruling by lifting its hormone ban, the United States, in July 1999, sought and obtained WTO authorization to impose restrictive tariffs on imports from the EU worth $116.8 million annually. Subsequent efforts to negotiate a compensation agreement that would have enlarged the EU's quota for non-hormone treated beef from the United States in exchange for lifting the punitive duties were not successful.

In October of 2003, the EU announced that its Scientific Committee on Veterinary Measures had concluded that one of the six hormones in question — oestradiol 17 — should be considered carcinogenic and that for five others the current state of knowledge did not make it possible for the Committee to provide a quantitative assessment of their risks to consumers. As a result, the EU argued, its ban on hormone-treated meat was justified, and the United States (and Canada, which also had challenged the EU ban) should lift punitive duties. The United States and Canada refused on grounds that the scientific evidence produced by the EU Committee was not new information nor did it establish a risk to consumers from eating hormone-treated meat. In January 2005, the EU requested the establishment of a WTO dispute panel to determine if the United States and Canada are in violation of WTO rules by maintaining the prohibitive tariffs in light of the EU's claim that it has complied with the panel decision. The establishment of the panel was delayed, however, in part due to disagreement among the disputants about its membership. The panel was ultimately established in June 2005. In January 2006, the panel announced that because of the complexity of the issues and the procedural matters involved it could not deliver its decision until October 2006. The report was further delayed, again according to WTO officials, because of the complexity of the issues involved.

A final panel report, circulated to the parties on December 21, 2007, reportedly upheld a confidential interim panel ruling circulated in July 2007.[30] In the final report, the panel ruled that the EU's legislation with respect to the ban on hormone-treated meat did not comply with the SPS Agreement. The SPS agreement requires that food safety measures applied to imports be based on a risk assessment According to the SPS Agreement, if provisional measures to protect food health and safety are imposed, WTO members are obliged to seek a more objective risk assessment in a reasonable period of time. Reports indicate that the panel thought that the EU had not complied with the SPS Agreement requirement to seek a more objective risk assessment in a reasonable period of time. The panel also found that the United States (and co-complainant Canada) did not follow WTO dispute settlement rules and procedures to determine if their sanctions were still justified. WTO dispute settlement rules require a determination by the WTO that a country is not complying with the rules before enacting sanctions. Nevertheless, the decision will allow the United States to keep in place its prohibitive tariffs on such EU products as Roquefort cheese, goose liver, fruit juices, mustard, and pork products.

Approvals of Genetically Modified Organisms (GMOs)

The United States, Canada, and Argentina in May 2003 initiated a challenge in the WTO to the EU's *de facto* moratorium on approving new agricultural biotechnology products, in effect since 1998. Although the EU effectively lifted the moratorium in May 2004 by approving a genetically modified corn variety, the three countries contend the EU approval process for GMOs violates the SPS Agreement and is discriminatory and not transparent. The moratorium, according to U.S. estimates, costs U.S. corn growers some $300 million in exports to the EU annually. U.S. growers plant genetically modified corn mainly for weed and pest control. They do not segregate GMO from non-GMO varieties, because the U.S. regulatory system recognizes them (once approved for commercialization) as substantially equivalent to traditional varieties. The EU moratorium, U.S. officials contend, threatened U.S. agricultural exports not only to the EU, but also to other parts of the world where the EU approach to regulating agricultural biotechnology is taking hold. The EU approach presumes that the products of biotechnology are inherently different than their conventional counterparts and should be more closely regulated. Other exports, e.g., corn gluten feed and soybeans, also have been adversely affected by negative consumer attitudes in the EU about GMOs.

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[30] "Final Report Upholds Sanctions in U.S.-EU WTO Hormone Case", *Inside U.S. Trade*, January 11, 2008, viewed at [http://www.insidetrade.com/secure/dsply_nl_txt.asp?f=wto2002.ask&dh=101359414&q=]. The preliminary panel report is discussed in "Interim Ruling Faults EU Hormone Ban, U.S., Canada Sanctions", *Inside U.S. Trade*, August 17, 2007, viewed at [http://www.insidetrade.com/secure/dsply_nl_txt.asp?f=wto2002.ask&dh=88354671&q=hormones].

On February 7, 2006, the WTO dispute panel, in its report, ruled that a moratorium had existed, that bans on EU-approved genetically engineered crops in six EU member countries violated WTO rules, and that the EU failed to ensure that its approval procedures were conducted without "undue delay." The dispute panel's ruling, however, dismissed several other U.S. and co-complainant claims including claims that EU approval procedures were not based on appropriate risk assessment; that the EU unfairly applied different risk assessment standards for genetically engineered processing agents; and that the EU had unjustifiably discriminated between WTO members. The panel made no recommendations to the EU as to how to bring its practices in line with WTO rules, nor does the ruling appear to require the EU to change its regulatory framework for approving GE products. The panel did not address such sensitive issues as whether GE products are safe or whether an EU moratorium on GE approvals continued to exist. The EU did not appeal the panel's decision, but announced instead its intention to comply with the decisions of the panel. By mutual agreement, the United States and the EU set November 21, 2007 as the end of a reasonable period of time for implementation of the panel's report.

The "reasonable period of time" for EU compliance with the dispute panel's ruling was subsequently extended by mutual agreement to January 11, 2008. On that date, the U.S. Trade Representative announced that, while it was reserving its rights to retaliate, it would hold off seeking a compliance ruling. USTR indicated that it would work with the EU to normalize trade in biotechnology products.[31] No deadline was announced for making a decision with respect to retaliation. According to USTR, the EU's observance of a set of benchmarks, not yet announced, would determine the United States' next move in WTO dispute settlement.

The impact of the U.S.-EU GMO case is uncertain. Given widespread opposition to GMOs by EU consumers and environmentalists, it seems unlikely that U.S. exports of such products would increase in the near term as a result of the panel ruling and the U.S.-EU effort to "normalize" trade in GMO products. U.S. officials suggest, however, that since the panel's decision affirms that countries must conform their biotech regulations to international obligations, the trade impact in countries that have not yet adopted comprehensive biotech regulations could be positive. The decision also could strengthen the hand of the European Commission in dealing with member countries that maintain marketing/import bans on GMOs or that are contemplating biotech regulations stricter than those being implemented by the Commission. However, Austria and Hungary are still maintaining WTO-prohibited bans on genetically modified corn varieties approved by the EU Commission. More recently, France announced that it was invoking a safeguard prohibition on cultivation of a genetically engineered corn variety, the only biotech corn approved for cultivation in the EU. The EU Commission has 60 days in which to review and decide on the validity of this safeguard action.

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[31] USTR, January 14, 2008, "Statement on EC-Biotech Dispute" viewed at [http://www.ustr.gov/Document_Library/Press_Releases/2008/January/Statement_on_EC-Biotech_Dispute.html]

Protection of Geographical Indications (GIs)

GI's are place names (or words associated with a place) used to identify products (for example, Champagne, Tequila or Roquefort) which have a particular quality, reputation or other characteristic because they come from that place. The EU accords greater protection to GIs than does the United States and some other countries. As a result the issue of protecting GIs has arisen in WTO dispute settlement and in agriculture negotiations. In June 1999, the United States requested consultations with the EU over its regulations for the protection of GIs which the United States said discriminated against U.S. GIs. Consultations failed to resolve the dispute, and in 2003, the United States requested and won the establishment of a panel to adjudicate the dispute. The United States charged that the EU regulations violated the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) by failing to provide national treatment (i.e., imports treated the same as domestic products) for U.S. GI's within the EU and by failing to provide sufficient protection to pre-existing trademarks that are identical or similar to European GIs.

The EU regulation required that GIs from other countries could be registered in the EU only if the country in question accorded protection equivalent to that available in the EU. According to the United States this "reciprocity" provision in the EU (e.g., maintenance of a registry of names) was in violation of the national treatment requirement in TRIPS. The United States complained also about permitting coexistence of names (for example, *Budweiser* and Czech names that in translation are the same) as they might confuse consumers and call into question pre-existing trademarks rights such as those *Budweiser* has in several EU countries. The panel sided with the United States on the issue of national treatment, but with the EU on the issue of coexistence rights, which the panel said should be limited to GIs that already appear on the EU register, but not to translations. This decision, admittedly narrow, has particular importance for *Budweiser* which felt threatened by the ability of Czech producers to appropriate its trademark in translation following the Czech Republic's accession to the EU (May 2004).

The EU issued regulations in March 2006 to bring its protection of GIs into compliance with the WTO decision. Under the new regulations, non-EU companies will not have to apply for registration of GIs through their national governments; producers themselves can make these applications. The changed regulations also eliminate the requirements that non-EU applicants for GI protection must be from countries that make equivalent guarantees on their home market and for third countries to give EU GIs the same level of protection. Although U.S. business interests has generally welcomed the new regulations, USTR has indicated that, from its point of view, there may be some issues with respect to the protection accorded existing trademarks that need clarification or resolution.

The decision and the new regulations could have limited near-term commercial implications if U.S. producers of products associated with place names (e.g., Idaho potatoes or Florida oranges) seek registration in the EU. The decision also may have implications for Doha round negotiations on GIs. USTR has maintained that existing WTO intellectual property protections for GIs are sufficient and priority should be placed on WTO members meeting current obligations and not on expanding GI protection in the WTO Doha negotiations. The EU, however, continues to push for expanded GI protection for agricultural and other products in the current trade round and is linking agreements on GIs to negotiations of U.S. priorities in the round such as curbing trade-distorting domestic support, eliminating export subsidies, and cutting agricultural tariffs.

Trade in Services

Overview[32]

Like all developed market economies, the United States and EU are predominantly service economies. The service sector, which includes a range of economic activities including banking and insurance, and other financial services to express delivery, transportation, information technology, telecommunications and professional services such as accounting, engineering and legal services, as well as entertainment and wholesale and retail trade, accounts for over 75% of employment and output in both the U.S. and EU.[33]

The U.S. and the EU are the largest exporters of services, accounting for about 50% of world trade in services. The EU is also the largest U.S. trade partner in services. In 2006 U.S. exports of services to Europe totaled $164 billion, or 41% of overall U.S. exports of services. U.S. service imports from Europe in the same year totaled $137 billion (or 44% of total imports), giving the U.S. a trade surplus of $27 billion in services trade. At the same time, sales of services by U.S. affiliates in Europe and European affiliates in the U.S. tend to be about double the amount that is traded.[34]

While the U.S. federal government and individual states still impose selective barriers on a range of business, professional, legal, and transport services, the market for services in the EU tends to be more regulated and fragmented by different member states policies. Nevertheless, most EU Member States are actively deregulating service sectors, although at varying rates, and the European Commission has approached liberalization in a comprehensive way through implementation of a Services Directive that was passed in 2004. In addition to these efforts, liberalization of services barriers are being dealt with multilaterally in the context of the Doha Round and bilaterally in the context of efforts to enhance the market integration of selective service sectors. Two such efforts – the Air Transport Agreement and Financial Regulatory Dialogue – are discussed below.

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[32] This section was written by Raymond J. Ahearn, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

[33] For U.S. data, see Coalition of Service Industries Research and Education Foundation Report, *Services Drive U.S. Growth and Jobs: The Importance of Services by State and Congressional District,* June 2007.

[34] Survey of Current Business, October 2007 edition.

Air Transport Agreement[35]

The United States and European Union signed a first-stage Air Transport Agreement at the U.S.-EU summit of April 30, 2007. The Agreement, which had been under negotiation for four years, will replace existing bilateral agreements between the United States and individual EU member states and will substantially liberalize the transatlantic air services market. Congressional approval of this Executive Agreement is not required. The accord will allow every U.S. and EU airline to fly between any city in the EU and any city in the United States with no restrictions on the number of flights, routes, and aircraft provided they can reach agreements with airports for landing rights, gates, and counter space. It also will open to competition London's Heathrow Airport, where landing rights have been restricted to two British and two U.S. carriers (providing those airlines wishing to serve the airport are able to obtain takeoff/landing slots from incumbent airlines).

The Air Transport Agreement takes effect March 30, 2008. The European Commission predicts that the agreement will lower airline fares on transatlantic travel, expand the number of passengers by 50% over the next five years, and create 80,000 new jobs.[36] But the agreement is not without controversy. Many Europeans argue that it is not balanced because it does not give European carriers the right to fly between U.S. cities and maintains limits on EU ownership of U.S. airlines. While most U.S. airlines support the agreement, the major U.S. unions representing pilots, machinists, flight attendants, and baggage handlers oppose it on the grounds that it will lead to a further erosion of jobs, benefits, and wages.[37]

Air services between the U.S. and EU presently operate on the basis of bilateral agreements between individual member states of the EU and the U.S. Accordingly, European airlines can fly to the United States only from the countries where they are based as long as the U.S. has reached a bilateral agreement with the country in question. Air France, for example, can fly to a U.S. destination only from a French airport under a bilateral aviation agreement.

These bilateral agreements contain provisions that the European Court of Justice determined in November 2002 to be incompatible with Community law. In particular, the Court determined that some bilateral agreements with the U.S. discriminated between different EU airlines, breaking internal market rules. The Court ruling, in turn, created an impetus for negotiating a new legal framework for U.S.-EU aviation relations. The EU objective in the negotiations was the creation of a single market for air transport in which investment could flow freely and in which European and U.S. airlines would be able to provide air services without any restriction, including in the domestic markets of both parties.

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[35] This section was written by John W. Fischer, Specialist in Transportation Policy, Resources, Science and Industry Division.

[36] Flottau, Jens. "Cloudy Skies: This Year's Version of U.S./EU Open Skies Draws Mixed Responses Throughout Europe," *Aviation Week*, March 12, 2007.

[37] "Airlines, Pilot Group Lukewarm on First Stage of U.S.-EU Deal" *Aviation Daily*, December 3, 2007. p. 3.

Achievement of the EU objective in full would require significant legislative changes in the United States, in particular the removal of some existing legal restrictions on foreign ownership and control of U.S. airlines and cabotage (which restricts foreign airlines from making flights directly between U.S. cities). Because these issues remain very sensitive politically in the United States, the EU accepted that cabotage would not be included in a first-stage agreement if meaningful progress was made towards removal of U.S. foreign investment restrictions.[38]

While the air transport agreement did provide separate new investment regulations that eliminate for EU airlines numerous existing administrative rules that limit foreign participation in U.S. airline management, the requirement that foreign nationals not own more than 25% of the voting stock of a U.S. airline remained. Thus, the EU can be expected to take up the issues of cabotage and remaining restrictions on foreign investment in the second-stage agreement scheduled to begin no later than May 30, 2008.[39]

Financial Services Dialogue[40]

The financial market's regulatory dialogue between the United States and the European Union began in 2002. Most of the issues in the initial discussions are still ongoing, however, the discussions today are more narrowly focused. Earlier discussions were seeking more effective financial regulations in response to the break down of corporate governance as a result of a number of corporate scandals and on implementing the European Union's Financial Services Action Plan and the United States' Sarbanes-Oxley Act. The antiterrorism financing discussions are now narrowed to discussions between the European Commission and the U.S. Treasury Department on the protection of personal data on money wire transfers. EU discussions of establishing a Single European Payments Area have been accompanied by both sides reaching an agreement to open the European Union's markets to U.S. financial services companies. The following is a brief update of the United States and the European Union's financial markets regulatory discussions on harmonizing accounting standards, protecting personal financial data privacy, and opening European financial services markets to U.S. firms. Some other financial services issues being discussed are Basel II capital accord, and the sub-prime crisis, which is negatively impacting financial institutions on both sides of the Atlantic.

U.S.-EU Accounting Standards. For corporate governance, accounting standards are critical tools in enforcing supervisory control over corporations and financial institutions. The Securities and Exchange Commission (SEC) requires all publicly traded firms listed on the U.S. stock exchanges to use U.S. Generally Accepted Accounting Principles (GAAP) in reporting their financial statements to

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[38] European Parliament, *Committee on Transport and Tourism,* Draft Legislative Resolution on the EU-US aviation agreement. 2006/0058 (CNS), July 30, 2007.

[39] Clark, Nocola. "U.S. Aims to Ease EU Concern On Aviation Bill," *The International Herald Tribune,* July 18, 2007, p. 10.

[40] This section was written by Walter W. Eubanks, Specialist in Financial Institutions, Government and Finance Division.

the SEC. The European Union, on the other hand, adopted the International Financial Reporting Standard (IFRS). The main difference is that GAAP is a rule-based standard, while the IFRS is a principles-based standard, which is more flexible than GAAP. With EU and U.S. firms listed in each other's securities markets, it is important to have significant commonality in accounting standards. Furthermore, the implementation of the Sarbanes-Oxley Act has caused the European Commission to engage in a regulatory dialogue with U.S. authorities concerning equivalence in corporate governance.[41] On March 12, 2004, the European Commission announced that the SEC would recognize foreign companies' use of the International Financial Reporting Standards when reporting financial results, with a process to reconcile differences. While the SEC has allowed foreign companies to use the IFRS standard, the SEC has not allowed U.S. firms to use the IFRS, because the IFRS is not as comprehensive as GAAP.

The SEC and European Commission are in ongoing accounting standards talks. In July 2007, the SEC proposed dropping the U.S. GAAP reconciliation process in the 2004 agreement as long as EU firms use the International Financial Reporting Standards, and the SEC and EU continue to make progress in reconciling their accounting systems. The European Commission objected to keeping the reconciliation requirement. The SEC argued that the EU Commission's current stance would undermine true convergence and accounting compatibility for financial reporting, because each EU-member state has flexibility to modify the IFRS to accommodate national accounting practices. Filings made under the "German IFRS," "Dutch IFRS," and "Belgian IFRS" would not be the same. U.S. accounting firms generally support the SEC position arguing that jurisdictional differences in IFRS need to be avoided.[42]

Antiterrorism Financing and Personal Financial Data Protection. The European Commission's Justice and Home Affairs directorate is in talks with the U.S. Treasury Department concerning the protection of personal financial data in U.S.–EU antiterrorist financing enforcement. In June 2006, press reports revealed that U.S. authorities had been accessing the personal data of wire transfers handled by the Society for Worldwide Interbank Financial Telecommunication (SWIFT). SWIFT is a cooperative that supplies messaging services and interface software to 8,100 banks and financial institutions in more than 207 countries. The U.S. Treasury Department has argued that collecting and retaining wire transfer information from SWIFT is a crucial element in ongoing terrorism investigations. European data protection officials disagreed strongly, accusing SWIFT of violating the EU data privacy protection directive (law) by turning over millions of transaction records to U.S. officials. The EU data protection directive restricts transfer of data to countries that do not have privacy standards that the EU deems adequate. The EU does not deem the United States' privacy standards adequate.

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[41] European Commission, "Nine months left to deliver the FSAP," *Eighth Progress Report on the FSAP,* June 3, 2003, p. 14.

[42] Steve Burkholder, "Politics of Global Accounting Efforts Take Center Stage at Convergence Conference,"*BNA Banking Report,* October 8, 2007, p. 2.

While the talks continued with the U.S. Treasury Department and the EU Commission, SWIFT announced significant changes to its operations to address the antiterrorist financing personal data protection issue. On October 4, 2007, the SWIFT board approved a plan to add a new operation center in Switzerland by the end of 2009 that will allow all intra-European financial transfers not involving the United States to be handled completely within the European economic area. Currently, SWIFT has operation centers in Europe and the United States to handle intra-European and transatlantic transfers. Transfers are processed simultaneously at both the European and U.S. locations, including those conducted among exclusively European countries. While the protracted negotiation continues, on June 28, 2007, the United States and the European Commission agreed to allow U.S. antiterrorism authorities, mostly in the U.S. Treasury Department, to use SWIFT data for their investigations, while protecting EU citizens' data privacy. However, SWIFT is required to inform EU customers that their data could be given to U.S. authorities, and that EU citizens should apply for their membership in the EU-U.S. safe harbor program. The safe harbor program was negotiated in 2000 to provide a way for entities to transfer personal data from EU-member states to the United States. It is a self-certifying program that confirms that the entities (now citizens) have adhered to a set of data privacy protection principles. Under the safe harbor program, EU citizens' privacy is protected because the U.S. firms involved in these data transactions have agreed to principles of conduct that protect the privacy of the transactions. The EU/U.S. negotiating team was expected to complete their work in the third quarter of 2007, but there was no formal announcement that they met that expectation.

Opening EU Markets to U.S. Financial Services Companies. While the United States and the European Union reached an agreement on September 2006 to open European markets to U.S. services companies including financial services, the European Commission sued 24 member states for failing to implement a financial services directive. This directive would open the financial services markets to both the United States as well as EU member states. Specifically, the European Commission took legal action against 24 European Union member states for failure to implement the necessary laws and regulations to break down national laws that prevent cross-border capital markets to operate efficiently. The Commission, the executive body of the EU, took legal action because only three member states – the United Kingdom, Romania and Ireland – met the January 31, 2006 deadline to implement the Markets in Financial Instruments Directive (MiFID). Consequently, the EU financial services markets remain restrictive.

U.S. firms would have greater access to EU financial services markets if EU markets were more open for EU member states' financial firms. With no restrictions, U.S. firms would have to comply with one set of laws and regulations instead of 27 (the three that have enacted the national laws and the 24 that have been sued). The MiFID was to establish the single passport system, which would allow investment firms to operate throughout the EU under the supervision of the financial services regulator of the member state where the firm is based. Currently, like the U.S. financial firms operating in the EU, EU financial services firms must abide by the regulation of the member state in which they are doing business. The deadline set in the MiFID was November 1, 2007. The failure of the European national governments to implement MiFID legislation places the financial services markets' unification plans at risk. According to the European Commission, "In this situation there is a risk that member states can face legal action by private parties who might claim damages for losses incurred because of late implementation of national legislation."[43] The risk of such damage claims is because financial firms throughout the EU have incurred major expenditures in preparation for the implementation of the MiFID. The U.K. Financial Services Authority has estimated the changes being made by financial firms in the UK could run up to $2 billion.

The EU/U.S. agreement to open EU markets to U.S. financial services firms while its financial services markets remain fragmented is of limited value to U.S. firms wanting to expand internationally, because of the high cost of operating under 25 countries' laws and regulations instead of one. Supporting this argument, in a report published September 20, 2007, the Organization for Economic Cooperation and Development (OECD) urged the European Union to address the integration of Europe's banking and financial sectors.

Other U.S.-EU Financial Services Issues. Several additional areas of EU/U.S. financial services regulation have yet to be resolved. Among them are the implementation of the Basel II capital accord, and EU regulatory response to the sub-prime market crisis.

- The United States is set to implement its version of the Basel II capital accord, while the EU has implemented its Basel II accord more than a year ago. Basel II is an international agreement that provides a framework for determining the minimum capital that depository institutions are required to hold as a cushion against insolvency. Basel II attempts to improve the risk sensitivity of Basel I (the current capital accord) in determining required capital. Countries whose banks are allowed to hold less capital have a competitive advantage over banks that are required to hold more capital. Analysts expect some new negotiations between the U.S. and the EU to level the playing field when the U.S. Basel II is fully implemented. The U.S. version could advantage or disadvantage EU banks that are in competition with U.S. banks.

- Many EU banks have experienced a liquidity crisis due to the U.S. subprime mortgage foreclosures and defaults, a situation that was temporarily remedied by the European central bank (ECB) providing needed liquidity to these troubled institutions. For example, the ECB had to provide a German bank a $23 billion line of credit because of losses it incurred from defaulted loans in the U.S. subprime market. The impact of the U.S. subprime crisis on European institutions has brought calls for a European Commission investigation of U.S. rating agencies such as Standard & Poors and Moody's for conflict of interest. In response, U.S. Senator Richard Shelby on August 20, 2007 urged the European Union to avoid

[43] For more information on developments the implementation of the MiFID, See the [http://ec.europa.eu/internal_market/securities/news_en.htm],visited January 15, 2008.

> unnecessary regulation of financial services as a result of the deteriorating subprime collapse.[44] U.S. remedies to the subprime crisis may result in legal actions from European investors. For example, U.S. Treasury Secretary Paulson's plan to freeze certain mortgage interest rates would expose European investors to losses that they might not find acceptable.

Foreign Direct Investment

Overview[45]

The fact that each side has a major ownership stake in the other's market may be the most distinctive aspect of the transatlantic economy. At the end of 2006, the total stock of two-way direct investment reached $2.2 trillion (composed of $1.1 trillion of U.S. direct investment in EU countries and $1.1 trillion of EU direct investments in the U.S.), making U.S. and European companies the largest investors in each other's market. Roughly 47% of all U.S. foreign direct investment is located in Europe, while EU member states supply 62% of foreign direct investment in the United States. As viewed in **Tables 4** and **5**, these high magnitudes have remained constant over the past eight years.

Table 4: Foreign Direct Investment in the United States on a Historical Cost Basis, Percentage Share

Region	1999	2000	2001	2002	2003	2004	2005	2006
EU*	60	64	64	64	61	62	62	62
Asia	19	15	14	14	14	15	14	15
Canada	9	9	8	7	7	8	10	9
Latin America	4	4	4	4	6	5	4	4

*EU 15 (1999-2003); EU-25 (2004-2006)

Source: Various editions of the Survey of Current Business

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[44] Joe Kirwin, "Selby Warns Subprime Collapse Fallout will Worsen as Union Slams Commissioner," *BNA Banking Report*, August 27, 2007.

[45] This section was written by Raymond J. Ahearn, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

Table 5: U.S. Direct Investment Position Abroad on a Historical Cost Basis, Percentage Share

Region	1999	2000	2001	2002	2003	2004	2005	2006
EU*	46	46	46	47	48	49	47	47
Asia	16	16	16	17	16	17	18	18
Canada	10	10	10	10	11	10	11	10
Latin America	21	20	20	18	17	16	17	17

* EU 15 (1999-2003); EU-25 (2004-2006)

Source: Various editions of the Survey of Current Business

This massive amount of ownership of companies in each other's markets translates into billions of dollars of sales, profits, production, and expenditures on research and development. In addition, an estimated six to seven million Americans are employed by European affiliates operating in the United States and almost an equal number of EU citizens work for American companies in Europe.[46]

As these data might suggest, both the U.S. and EU have policies that are receptive to FDI. In theory, both sides appear to acknowledge that there is nothing to gain from protectionist investment policies. Differences exist, however, in term of remaining irritants and barriers on both sides of the Atlantic.

A good portion of FDI activity involves the acquisition of new plant and equipment, the bulk of it centers on merger and acquisition (M&A) activity. EU M&A activity in the United States, for example, totaled $114 billion in 2006, up from $57 billion in 2005.[47] While M&A activity is not controversial per se, from time to time regulation of business activities through application of competition or antitrust polices has created transatlantic tensions. This came to light in 2002 when Europe prevented General Electric from merging with Honeywell. Most recently, the EU's decision on Microsoft's alleged abuse of its dominant position heightened concerns over different approaches to antitrust law in the U.S. and Europe. These main differences and their significance are discussed below.

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[46] Center for Transatlantic Relations, Johns Hopkins University, *The Transatlantic Economy 2008, Executive Summary*, by Daniel S. Hamilton and Joseph P. Quinlan. Available at [http://transatlantic.sais-jhu.edu]

[47] Ibid.

U.S. and EU Perspectives on Antitrust and Competition[48]

Fifteen years ago, few national or super-national jurisdictions had competition laws and even fewer of them enforced those laws. Today, more than 100 jurisdictions have such laws, which increasingly are being enforced. The United States has played a significant role in encouraging the spread of competition laws, and now has a strong interest in promoting convergence toward sound enforcement of those laws.[49]

Multinational firms, competition agencies, and antitrust practitioners (attorneys and economists) have been especially interested in fostering convergence between the United States and the European Union. A number of conferences and symposiums on both sides of the Atlantic have addressed the issue, and American and European researchers continue to analyze the impact of agency policies and specific decisions.[50] Although there is general agreement that the United States and the EU are moving toward substantial antitrust convergence in the areas of cartels

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[48] This section was written by Charles B. Goldfarb, Specialist in Telecommunications Policy, Resources, Science, and Industry Division, and Janice E. Rubin, Legislative Attorney, American Law Division.

[49] *See, for example*, Randolph W. Tritell, "International Antitrust Convergence: A Positive View," 19 Antitrust 25 (Summer 2005). The United States seeks convergence, rather than harmonization, of antitrust policy because harmonization implies uniformity of legal provisions or their application, which would be impractical given the variation across jurisdictions in levels of economic development, legal systems, histories, and cultures.

[50] *See, for example*, Margaret Bloom, "The U.S. and EU Move Towards Substantial Antitrust Convergence on Consumer Welfare Based Enforcement," 19 Antitrust 18 (Summer 2005); Tritell, *supra*, note 49; Ronald W. Davis and Jennifer M. Driscoll, "The Urge to Converge – The New EU Discussion Paper on Abuse of a Dominant Position," 20 Antitrust 82 (Spring 2006); Eleanor M. Fox, "What is Harm to Competition? Exclusion Practices and Anticompetitive Effect," 70 Antitrust Law Journal 371 (2002); Eleanor M. Fox, "Monopolization, Abuse of Dominance, and the Indeterminancy of Economics: The U.S./E.U. Divide," Utah Law Review 725 (2006); John Vickers, "Competition Law and Economics: a Mid-Atlantic Viewpoint," 3 European Competition Law Journal 1 (2007); J. Thomas Rosch, Commissioner Federal Trade Commission, "Has the Pendulum Swung Too Far: Some Reflections on U.S. and EC Jurisprudence," based on remarks presented at the Bates White Fourth Annual Antitrust Conference (Washington, D.C., June 25, 2007); J. Thomas Rosch, Commissioner, Federal Trade Commission, "I Say Monopoly, You Say Dominance: The Continuing Divide on the Treatment of Dominant Firms, Is it the Economics?," presentation at the International Bar Association, Antitrust Section Conference (Florence, Italy, September 8, 2007); Thomas O. Barnett, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Global Antitrust Enforcement," presented at the Georgetown Law Global Antitrust Enforcement Symposium (Washington, D.C., September 26, 2007); Thomas O. Barnett, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "The Gates of Creative Destruction: The Need for Clear and Objective Standards for Enforcing Section 2 of the Sherman Act," opening remarks for the Antitrust Division and Federal Trade Commission Hearings Regarding Section 2 of the Sherman Act (Washington, D.C., June 20, 2006), at 9-10; J. Bruce McDonald, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Section 2 and Article 82: Cowboys and Gentlemen," remarks presented to the Second Annual Conference of the College of Europe (Brussels, June 16-17, 2005).

and horizontal mergers, differences remain with respect to enforcement of the unilateral conduct of dominant or monopoly firms (often as they relate to vertical relationships) – such as bundled discounts, loyalty discounts, tying, refusals to deal, exclusive dealing, and predatory pricing.[51] These differences reflect differences in the underlying laws, as well as in important historical developments.

That the United States and EU may, on occasion, reach differing conclusions about the competition/antitrust lawfulness of an entity's activities is understandable when one examines the language of their respective, relevant statutes. U.S. law addresses "monopolization," while EU law addresses "dominance."

"Monopolization" in the United States. Section 2 of the Sherman Act (15 U.S.C. § 2) prohibits "monopolization" (a situation in which a monopolist couples its monopoly status with behavior designed to unlawfully exploit, maintain, or enhance its market position) and "attempted monopolization" (a situation in which an entity unlawfully attempts to secure a market monopoly).[52] A shorthand definition of "monopoly" is "the power to control prices or exclude competition."[53] While it is not illegal for a company to have or to seek to achieve a monopoly position, "the willful acquisition or maintenance of monopoly power ... by the use of exclusionary conduct"[54] is illegal.

In the United States:

- vertical restraints are no longer considered per se illegal, but rather are judged under the rule of reason (i.e., a method of antitrust analysis under which a technical antitrust violation may be saved by balancing the anti-competitive results against any pro-competitive effects), and in recent years such restraints rarely have been successfully challenged;

- predatory pricing (the practice of a firm with market power temporarily selling a product at a below-cost price with the intent of driving competitors out of the market or keeping potential entrants out of the market, and raising its prices again when those objectives have been largely achieved and it is, therefore, able to recoup its losses) rarely is challenged by the antitrust agencies;

- claims that specific refusals to deal, monopoly leveraging, or refusals to provide access to essential facilities tend to be met with some skepticism by the antitrust agencies and courts.

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[51] *See, for example,* Bloom, *supra,* note 50; and Rosch,"I Say Monopoly ...,"*supra,* note 50.

[52] For a more detailed discussion of U.S. law on monopolization, see CRS Report RL33708, *The Distinction Between Monopoly and Monopolization in Antitrust Law,* by Janice E. Rubin.

[53] *See, e.g.,* United States v. E.I. duPont de Nemours & Co., 351 U.S. 377, 391-92 (1956).

[54] *See* McDonald, *supra,* note 50.

Those unilateral practices are not generally prosecuted because either they are not deemed to harm competition or the allegation itself is unprovable.

Consumers are presumed to benefit from the existence of largely competitive markets. The impact on excluded *competitors* is relevant only insofar as it affects the fate of *competition*:

> [t]he antitrust injury requirement obligates [complainants] to demonstrate, as a threshold matter, "that the challenged conduct has had an actual adverse effect on competition as a whole in the relevant market; to prove it has been harmed as an individual competitor will not suffice."[55]
>
> ... it is axiomatic that the antitrust laws were passed for "the protection of *competition, not competitors.*"[56]

In scrutinizing the effects of a firm's actions on competition, U.S. courts have increasingly turned to what supporters call "economic principles"[57] and what detractors call "the conservative economic scholarship of the 'Chicago School'"[58] to focus Section 2 on the consumer welfare and economic efficiency effects of those actions. Under this microeconomic model, there should not be antitrust intervention unless the activity is likely to diminish aggregate consumer wealth. Exploitation of monopoly power is not a violation of Section 2 unless there is harm to consumers.

There is debate among economists, however, about what constitutes "consumer welfare" or "consumer wealth" or "harm to consumers." Chicago School economists tend to construe these concepts broadly, to include society's wealth as a whole, that is, to include the wealth of both consumers and producers. Thus, an activity that decreases the welfare of end-user consumers, but increases the welfare of producers by a greater amount, would be viewed as increasing total consumer welfare. In contrast, more liberal economists tend to construe "consumer welfare" and "consumer wealth" and "harm to consumers" more narrowly and some argue that antitrust analysis should focus on "consumer surplus," which measures the effect on end-user consumers only.

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[55] Anheuser-Busch, Inc. v. G.T. Britts Distributing, Inc., 44 F.Supp. 2d, 172, 174 (N.D.N.Y. 1999), *quoting* George Haug Co. v. Rolls Royce Motor Cars, Inc., 148 F.3d 136, 139 (2d Cir. 1998), which *quoted* Capitol Imaging v. Mohawk Valley Med. Assocs., 996 F2d 537, 543 (2d Cir. 1993), *cert. denied*, 510 U.S. 947 (1993).

[56] Wichita Clinic, P.A. v. Columbia/HCA Healthcare Corp., 45 F.Supp. 2d 1164, 1193 (D. Kansas 1999), *quoting* Brooke Group v. Brown & Williamson Tobacco, 509 U.S. 209, 224 (1993), *quoting* Brown Shoe v. United States, 370 U.S. 294, 320 (1962 (emphasis in Brown Shoe).

[57] *See, for example*, Thomas O. Barnett, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, "Competition Law and Policy Modernization: Lessons from the U.S. Common-Law Experience," presentation to the Lisbon Conference on Competition Law and Economics, Lisbon, Portugal, November 16, 2007.

[58] *See, for example,* Rosch, "Has the Pendulum Swung Too Far: ...," *supra*, note 50.

The Chicago School approach adopted by the U.S. courts has been characterized by one observer as an "outcome-oriented definition of competition and impairment,"[59] with a single relevant outcome measure – the impact on consumer welfare as that term is broadly defined. It has an important corollary: Section 2 has not been interpreted to provide protection to smaller rivals from aggressive competition by monopolists unless consumers are being harmed.

"Dominance" in the EU. In contrast, Article 82 (as amended) of the Treaty of Rome that established the European Community reads:

> Any abuse by one or more undertakings of a *dominant position* within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.[60]

Pursuant to Article 82, such abuse may consist of:

- directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- limiting production, markets or technical development to the prejudice of consumers;
- applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and
- making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

Given the references to unfairness and competitive disadvantage, Article 82 has been interpreted to be concerned with market effects on competitors as well as on consumers. In evaluating dominant firms' actions, the EU has tended to employ "post-Chicago School" economic models that focus on strategic game theory and are not as skeptical about the potential for competitive injury as are the Chicago School models relied on in the United States.[61] A determination of whether there is harm to

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[59] Fox, *supra*, note 50.

[60] Emphasis added. Excerpted from "CONSOLIDATED VERSION OF THE TREATY ESTABLISHING THE EUROPEAN COMMUNITY," as that document appears on the EU website, [http://eur-lex.europa. eu/en/treaties/dat/12002E/htm/C_2002325EN .003301.html#anArt82], viewed on January 28, 2008.

[61] *See, for example*, Rosch, "I Say Monopoly ...," *supra,* note 50. The post-Chicago School models also tend to focus on consumer surplus and not include in consumer welfare the producer surplus that a dominant firm may capture from its actions.

competition "asks whether the practice interferes with and degrades the market mechanism."[62]

One observer has voiced concern that "enforcement of the law under a 'protection of the market' paradigm can spill over into protection of competitors."[63] There is no consensus, however, as to whether that has occurred in the EU, though case law in the EU has been harsh on dominant firms that employ loyalty rebates, bundled discounts on multiple products, exclusive dealing, tying arrangements, refusals to deal, and refusals to license, while such activities are rarely found to be illegal – and in some cases are in effect per se legal – in the United States.[64]

Impact of different laws and philosophies. Although both the United States and the EU look toward consumer welfare as the hoped-for end product of their enforcement actions,[65] their philosophies about the best means to arrive at that goal do not always agree. The U.S. monopolization statute is based on the belief that consumers benefit most when markets function competitively, and so focuses on the effects of an entity's actions on competition and markets rather than on effects on competitors.[66] Article 82, on the other hand, appears more compatible with the notion that consumer benefit will best be realized when a dominant firm's adverse effects on competitors are minimized or prevented. Further, "abuse ... of a dominant position" may not always equate to "monopolization."[67] Moreover, as explained earlier, the United States employs a broader concept of consumer welfare when evaluating the effect of a firm's behavior, incorporating benefits to the producer, even if these come at the expense of consumers.

Accordingly, there have been times when U.S. authorities have found the actions of a dominant firm – even a monopolist – to be legal, or have agreed to a settlement that imposed relatively limited restrictions on a dominant firm, or have approved a merger, while EU authorities have found those same actions to be illegal, or have imposed far more restrictive settlement terms on the dominant firm, or have

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[62] Fox, *supra*, note 50.

[63] *Id.*

[64] *See, for example,* Davis and Driscoll, *supra,* note 50.

[65] *See, e.g.,* Philip Lowe, Director General, Directorate General for Competition, European Commission, "Remarks on Unilateral Conduct," Speech before a session of the Federal Trade Commission and Antitrust Division Hearings on Section 2 of the Sherman Act (Washington, D.C., September 11, 2006); McDonald, *supra,* note 50.

[66] *E.g.,* Spectrum Sports, Inc. v. McQuillan 506 U.S. 447, 458 (1993): "The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It does so not out of solicitude for private concerns but out of concern for the public interest." *See, also,* Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 488 (1977); Cargill, Inc. v. Monfort of Colorado, Inc., 479 U.S. 104, 116-117(1986); Brown Shoe Co. v. United States, 370 U.S. 294, 320 (1962).

[67] For a more thorough treatment of the difference in emphasis, *see* McDonald, *supra,* note 50.

disapproved a merger. Notable examples include complaints brought against Microsoft and the proposed merger between General Electric and Honeywell.

In 2004, the EU imposed on Microsoft both conduct remedies and a substantial fine for the bundling of its operating system and media software. (The European Commission began its investigation of Microsoft after receiving a complaint from Sun Microsystems, a multinational U.S. company that competed with Microsoft, alleging that Microsoft was refusing to supply necessary interoperability information.) Most of the Commission's decision was subsequently upheld by the European Court of First Instance.[68] The U.S. Department of Justice also brought a complaint against Microsoft, alleging that Microsoft had unlawfully attempted to "extend its operating system into other software markets." But the settlement it reached with Microsoft to "restrain anti-competitive conduct" was less far-reaching, and was unsuccessfully challenged by several states as not being stringent enough.[69] In January 2008 the EU announced, also subsequent to the complaint of a competitor, further investigations of Microsoft for "suspected abuse of dominant market position."[70]

Earlier, the EU had challenged and disapproved the proposed General Electric/Honeywell merger,[71] which had been approved by the U.S. authorities. While EU disapproval did not, technically, prevent the merger, it was likely a prominent factor in the decision of those companies not to consummate the merger as it would have prevented the merged entity from doing business within the EU.

Some observers, therefore, have questioned whether the EU has been using its antitrust laws and policies to protect its businesses from U.S. competition.[72] Alternatively, given that the complaints about dominant firm behavior or opposition to proposed mergers often have come from U.S. companies that (would) compete with those dominant or merged firms, other observers have accused the complaining firms of jurisdiction-shopping when they fail to get the relief they seek from U.S.

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[68] Commission Decision in Case COMP/C-3/37.792 Microsoft (2004); Microsoft Corp. v. Commission of the European Communities, No. T-201/4 (EU Ct. 1st Inst. 2007).

[69] 87 F.Supp. 2d 30 (D.D.C. 2000) ("Conclusions of Law"); 97 F.Supp. 2d 59 (D.D.C. 2000) ("Final Judgment"); *aff'd in part, rev. in part,* "Final Judgment" *vacated, remanded to be assigned to new judge*, 253 F.3d 34 (D.C. Cir. 2001); *cert. den*., 534 U.S. 952 (2001); *on remand*, 231 F.Supp.2d 144 (D.D.C. 2002); *aff'd sub nom.*,Massachusetts v. Microsoft Corp., 373 F.3d 1199 (D.C.Cir. 2004).

[70] EU Press Release re MEMO/08/19 (Brussels, 1/14/2008).

[71] The Competition Commission's decision was rendered in July 2001, and affirmed by the Court of First Instance in December 2005 (General Electric Co. v. Commission of European Communities, Case No. T-210/01, Honeywell v. Commission of European Communities, Case No. T-209/01 (CFI 2005).

[72] *See, for example,* "FreedomWorks, Dick Armey Criticize European Ruling Against Microsoft,"September 17, 2007, available at [http://www.freedomworks.org/newsroom /press_template.php?press_id=2314], viewed on January 7, 2008.

antitrust agencies or U.S. courts.[73] A third set of observers argues that antitrust enforcement has been minimal in the United States and therefore the EU is playing an essential role in protecting consumers and actual and potential competition.[74]

Commentators have identified two factors that may explain why competition law has developed differently in the United States and the EU. First, until recently, many sectors in the European economy were characterized by large government-owned monopolies and as those entities have moved toward privatization and competitive entry has been allowed, there has been concern that those dominant incumbent firms could exploit their positions to limit the effectiveness of competition. Thus, EU competition policy has focused on protecting the market mechanism from practices that might not be viewed as illegal in the United States because they might not have an impact on consumers. From this perspective, it is historical coincidence that more stringent EU laws are being applied to dominant U.S. firms. In contrast, although there were government-sanctioned monopolies in the United States – notably in telecommunications and electricity markets – the firms in those industries were not government entities and comprised a much smaller portion of the overall economy than did their EU counterparts. Thus, antitrust law, policy, and enforcement have been less concerned about protecting market mechanisms, which are viewed as robust.[75]

Second, the U.S. antitrust agencies and the courts may have been concerned that markets have been distorted by the high cost of antitrust litigation, with resulting losses in efficiency, due to certain features that have not been adopted in Europe – e.g., private enforcement of the antitrust laws, class action law suits, extensive rights to discovery, and lay juries. They therefore may have preferred policies that

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[73] *See, for example,* Scott M. Fulton, III, "US Antitrust Chief, EU Competition Chief Spar Over Microsoft," *betanews at CES '08,* September 20, 2007, available at [http://www.betanews.com/article/US-Antitrust_Chief_EU_Competition_Chief_Spar_Over_Microsoft/119029934], viewed on January 7, 2008.

[74] *See, for example*, American Antitrust Institute, "Microsoft, the European Union, and the United States: A Statement by the AAI," September 24, 2007, available at [http://www.antitrustinstitute. org/Archives/miceu3.ashx], viewed on January 28, 2008. Representatives of the U.S. and EU competition agencies, however, have continued to stress their close working relationship despite their sometimes high-profile disagreements. *See, e.g.,* "U.S., EU Enforcers Concede Differences, Stress Necessity for Continued Cooperation," 81 Antitrust & Trade Regulation Report 462 (11/23/2001).

[75] Congress passed legislation to guide the transition from monopoly to competition in those markets, imposing certain requirements on the incumbent firms that were intended to foster competitive entry. For example, the Telecommunications Act of 1996 (P.L. 104-104) imposed certain requirements on the Bell Operating Companies to provide new entrants access to their networks during the transition. The U.S. Supreme Court ruled, in a private antitrust challenge, that violation of the act's requirements by an incumbent telecommunications firm did not also constitute an antitrust violation since those regulatory requirements exceeded those of the antitrust laws. (*Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko,* 540 U.S. 398 (2004)) For a detailed discussion of the *Trinko* decision, *see* CRS Report RS21723, *Verizon Communications, Inc. v. Trinko: Telecommunications Consumers Cannot Use Antitrust Laws to Remedy Access Violations of Telecommunications Law*, by Janice E. Rubin.

constrain litigation. To this end, the U.S. agencies and courts have chosen to carve out "safe harbors" for certain activities where the dominant firm may in fact be exploiting its monopoly position but where it would be difficult to demonstrate consumer harm.[76] These are the same activities that often are successfully challenged in the EU – e.g., loyalty rebates, bundled discounts, exclusive dealing, tying arrangements, refusals to deal or license.

Prospects

On balance, U.S.-EU commercial relations are healthy and mutually advantageous. While the future course of the relationship is difficult to predict, there are major forces both for cooperation and conflict that will have an important bearing on the direction of the relationship. The most salient of these considerations are presented below.

Forces for Cooperation

The forces for cooperation are both economic and political. Three important factors are integration of markets, institutional arrangements, and a shared interest in maintaining and advancing the multilateral world trading system.

Integration of Markets. The sheer size and importance of commercial ties is a key force for cooperation. A growing number of companies in both the United States and Europe view the size, dynamism, and relative openness of each other's markets as critical to their commercial success. From the U.S. perspective, the EU market is increasingly open, standardized and growing. From the EU perspective, the U.S . remains the largest open market in the world. The six to seven million jobs on both sides of the Atlantic dependent on tightly integrated markets give rise to strong and politically active interest groups that lobby in favor of maintaining friendly bilateral ties, reducing regulations, and in opposing protectionist proposals.

The high level of integration of markets, both in goods and capital, is accompanied by heated competition for market share. Market forces and competition are driving economic convergence in a number of policy areas, such as financial services and antitrust enforcement. In the process, some trade friction and the need for policy intervention may be avoided.

In the few cases where trade disputes have led to retaliation, the high degree of market integration has served as a fire-wall or buffer, insuring that retaliation does not become excessive. Due to the high degree of cross-investments and intra-industry trade, retaliation affecting the largest sectors of U.S.-EU trade (i.e. machinery, electrical machinery, optical equipment, aircraft, vehicles, organic chemicals, and pharmaceuticals) is highly unlikely. This is because many of the products in these sectors are used in the production process by the other side. Thus, it becomes impossible to hurt the other without disrupting one's own producer interests and thousands of jobs on both sides of the Atlantic.

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[76] *See, for example,* Barnett, "The Gates of Creative Destruction: ...," *supra*, note 50.

Institutional Arrangements. Various institutions and annual high-level meetings are also working to keep the relationship on an even keel. Beginning in the 1990s, the U.S. and EU agreed to an expanded range of dialogue and cooperation. Under the 1995 New Transatlantic Agenda (NTA), both sides tried to make progress on a positive economic agenda achievable in the short run. The NTA has been followed by a number of other specific bilateral initiatives designed to tackle remaining barriers, many of which involve regulation rather than traditional tariffs or quotas. The Transatlantic Economic Council (TEC) is the most recent institution established to reinvigorate efforts to resolve remaining disputes and to deepen the level of economic integration. Whether the TEC will prove a more successful entity for reducing remaining transatlantic regulatory and non-tariff barriers to trade remains uncertain.

There appears to be little support, however, for any big new policy initiative such as a Transatlantic Free Trade Area. This may be due, in large part, to continuing differences over agricultural policy. In the past, such initiatives have been proposed by those who hoped that U.S.-EU political relations could be bolstered by a grander economic foundation.

Shared Interest. The two sides share an important interest in promoting an open, stable, and multilateral world trading system. Both partners have placed a high priority on bringing the long-running Doha Round of multilateral trade negotiations to a successful conclusion. While U.S.-EU differences over agricultural policies continue to affect their ability to exert joint leadership, resistance on the part of key developing countries, such as India and Brazil, to a comprehensive Doha Round package of concessions has been a formidable reason for the continuing stalemate.

Given quite similar interests in bolstering the multilateral trading system, many analysts say that both sides could cooperate more in addressing the rising economic challenge posed by China. Specifically, they could work together to persuade China to abide by its WTO commitments, as well as to pressure China to let the value of its currency be determined by market forces. Cooperation of this kind could not only support U.S. and EU multilateral trade interests, but also promote stronger bilateral ties.

Forces for Conflict

While the United States and EU cooperate in a range of areas to the benefit of both sides, differences and disputes often attract more press coverage. The intractable nature of some disputes embedded in regulatory barriers, differences over the use of the WTO dispute settlement system, and rivalry could mean that conflict and tensions remain a seemingly durable feature of the relationship.

Intractable Problems. A number of U.S.-EU trade disputes have focused increasingly on differences in regulation, rather than traditional barriers such as tariffs or subsidies. Regulatory requirements established primarily with domestic consumer and environmental protection or public health concerns in mind are not designed to discriminate between domestic and imported goods and services. But they may have the secondary effect of distorting or discriminating against the free flow of international trade, which, in turn, could lead to disputes. For this reason, transatlantic regulatory disputes over beef hormones and genetically modified foods can be more bitter and difficult to resolve than traditional trade disputes, in so far as both sides feel their actions are justified by democratically derived decisions.

There have been specific challenges raised by the application of modern biotechnology to food production. The Uruguay Round Sanitary and Phytosanitary Standards (SPS) Agreement was designed to deal with this issue. It requires countries that impose regulations or trade bans to protect the health of plants, animals, and people to base such decisions on risk assessments derived from scientific evidence.[77] But the SPS requirement of a sound scientific basis is open to varying interpretations.

Ambiguities in the SPS agreement are complicated because many European consumers believe that avoidance of production practices associated with biotechnology is a value in itself. For these consumers, scientific studies showing that such technologies do not result in threats to human or animal health may not be convincing. Given these strong views, many European officials want leeway to impose trade restrictions on a "precautionary basis" and others want to renegotiate the SPS agreement. Both avenues could open up a large loophole for discriminatory trade barriers.

Even if these conflicts are not primarily due to the deliberate use of health, safety, or environmental standards as trade barriers, mistrust grows in terms of how much effort government authorities may have put into managing public concerns through educational efforts. Under these circumstances, disputes resulting from such differences are unlikely to be resolved; at best they may be contained.

WTO Differences. The United States and EU are the most active participants in the WTO Dispute Settlement System, both as petitioning and defending parties. U.S. cases against the EU tend to revolve around closure of markets to U.S. exporters or the adverse impact of state intervention or aid on U.S. sales in third markets. Cases involving beef hormones and GMOs fall in the first category and Boeing's complaint against Airbus in the latter category. EU complaints against the U.S., on the other hand, tend to involve more technical concerns about U.S. trade or tax law that are inconsistent with WTO obligations and that may confer indirect advantages for U.S. firms.

These varied approaches, which have caused considerable transatlantic tension, particularly in the case of the EU's challenge to U.S. tax benefits for exporters, have their roots in very different institutional arrangements. On the U.S. side, private sector concerns are formally considered in the trade policy making process. As a result, denial of market access opportunities is a priority concern for U.S. trade policymakers. On the other hand, some observers maintain that the EU often uses trade for foreign policy purposes by challenging the United States on a wide range of mostly technical issues. Not only does this approach allegedly help bolster the European Commission's role vis-a-vis member states as the protector of EU interests,

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[77] A related multilateral code, the Agreement on Technical Barriers to Trade (TBT), covers other types of regulations such as labeling and packaging.

but also promotes its image as a leading defender of rule-based multilateralism and global governance.[78]

Rivalry. A straightforward explanation for many transatlantic trade disputes may be that the U.S. and EU both aspire to lead in setting rules for global trade and investment, including environmental and safety rules that impinge on trade. The United States may think its rules should prevail given the historically dominant role of the U.S. economy. The EU is itself a system of market liberalization, and it could use trade to spread its own model of regulation and market integration to the rest of the world. If successful, European rules on regulations affecting health and safety, competition policy, government procurement, and investment will shape future parameters of trade liberalization. Beyond indirectly challenging the United States for global trade leadership, this process of spreading rules and regulations for trade may also be intended to facilitate commercial success for European companies.[79]

There is also a concern that competition between the United States and the EU to secure bilateral and regional trade agreements could have negative consequences for the world trading system. The efforts of both sides to cut deals bilaterally and regionally is a form of normal commercial rivalry between two superpowers for markets, jobs, and profits. However, some analysts worry that that such competition could foster a form of rival regionalism that undercuts the multilateral trading system on which both depend.

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[78] John Van Oudenaren, *Uniting Europe*, Rowman & Littlefield Publishers, 2005, p. 376.

[79] Sophie Meunier and Kalypso Nicolaidis, "The European Union as a conflicted trade power," *Journal of European Public Policy*, 13:6 September 2006: p. 912; and Bruce Stokes, "Bilateralism Trumps Multilateralism," *National Journal*, December 16, 2006.