

# U.S.-EU TRADE RELATIONS: SOURCES OF FRICTION AND PROSPECTS FOR RESOLUTION

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## I. INTRODUCTION

I would like to begin by discussing several of the most crucial trade disputes confronting the United States and the European Union. I will then look at several factors that continue to link the United States and the EU from a trade perspective. Finally, I will address the focus of this panel: are these trade disputes symptomatic of a broader, overall divergence of U.S. and European interests and perspectives?

## II. SOURCES OF FRICTION—SELECTED WTO DISPUTES

The United States and the European Union are currently facing an array of complex, high profile trade disputes. This is not surprising, because these entities make up the world's single largest and most important bilateral trade relationship. The flow of goods, services and investment between the two totals

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more than US \$1 billion every day. EU imports and exports of goods account for about 20% and 25%, respectively, of U.S. trade. The EU comprises about 40% of all U.S. trade in services, and the two entities account for about 50% of each other's foreign direct investment.<sup>1</sup>

It comes as no surprise, then, that this relationship has given rise to trade disputes. These disputes, like the trade from which they arise, are large and complex. Several of these disputes have reached—or are soon to reach—a critical point.

#### A. *Foreign Sales Corporations*

One of the largest and most intractable disputes of the last few years has been the United States' tax treatment of Foreign Sales Corporations (FSC). In this dispute, the EC had challenged a provision of the U.S. Internal Revenue Code under which these FSCs were provided tax exemptions for foreign trade income. The EC challenged the exemptions as prohibited export subsidies. A WTO Panel and Appellate Body agreed, in 1999 and 2000, respectively.<sup>2</sup>

In response, the United States repealed the FSC and passed the Extraterritorial Income Exclusion Act (ETI) in late 2000. The EC challenged this legislation as well, and again, both a WTO panel and the Appellate Body found that the ETI Act violated the United States' international obligations. The EU had already requested authorization from the Dispute Settlement Body to suspend trade concessions in the amount of \$4 billion per year.

Since then, the United States has struggled to implement legislation that would conform U.S. law to the WTO ruling. Competing proposals from the chairs of the relevant House and Senate committees are moving forward as we speak.

House Ways and Means Committee Chairman Thomas has offered legislation that would repeal FSC and ETI and replace those programs with two corporate tax cuts: one, a 3 percent tax rate cut to all U.S. corporations over six years, and two, a tax rate reduction of small and medium-sized businesses.

The EU, understandably, is pressing for enactment of corrective legislation. In particular, the EU has called for repeal of FSC/ETI by the end of this year. Earlier this month, the European Commission began the procedure of developing legislation allowing sanctions that would automatically take effect if repeal does not occur by yearend.

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1. Charles W. Smitherman III, *The New Transatlantic Marketplace: A Contemporary Analysis of United States-European Union Trade Relations and Possibilities for the Future*, 12 MINN. J. GLOBAL TRADE 251, 255 (2003).

2. United States-Tax Treatment for Foreign Sales Corporations, WT/DS108/AB/R at 153 (Feb. 24, 2000).

Commissioner Lamy has also commented directly on the pending FSC legislation, making two particular objections. First, the EU argues that the three-year transition period included in the legislation is far too long, since the United States has already had three years to make the necessary changes. Second, the EU objects to a “grandfather” provision that would maintain existing FSC benefits previously established under long-term contracts.

Recently, Commissioner Lamy wrote several key members of House Ways and Means, and included the following language, which I think is enlightening:

“It would send a very strong signal of transatlantic co-operation to successfully conclude this complex, sensitive and long-running dispute without resorting to trade sanctions—sanctions which none of us want.”<sup>3</sup>

### B. *Steel Safeguards Measures*

A second hot topic that rivals FSC in terms of size, complexity and political intrigue is the steel safeguards proceeding.<sup>4</sup> This was the largest and most politically charged safeguards action ever taken, and this action has been condemned not only by the EU but also by most of our other trading partners as well. As we speak, the Bush Administration is deciding whether to keep the safeguard measures in place, modify them, or eliminate them altogether.

President Bush, who carried several critical steel-producing states in the 2000 election, initiated the 201 investigation, along with a call for global negotiations on steel subsidies and overcapacity. The goal was to “solve the steel problem once and for all.”

After one of the largest investigations in its history, the International Trade Commission made affirmative or divided findings on 16 out of 33 steel products, including most of the largest product categories.<sup>5</sup> In March 2002, the President imposed tariffs on 14 of these products, including 30% tariffs on the largest product groups. The President excluded our free-trade partners, including the NAFTA nations, and 100 developing countries.

The brunt of the tariffs, in large measure, fell on the European Union and Japan. The EU wasted no time in reacting. In June, it approved a retaliation list totaling 2.4 billion euros against various U.S. industries, and began threatening

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3. See e.g., Letter from Pascal Lamy, EU Commissioner, to Donald Manzullo, Congressman, U.S. House of Representatives (Oct. 7, 2003).

4. The author represents Nucor Corp. and the U.S. manufacturers of steel bars and other long steel products.

5. *Steel: Monitoring Developments in the Domestic Industry*, USITC Pub. 3632, Inv. Nos. TA-204-9 (Sept. 2003); *Steel - Consuming Industries: Competitive Conditions with Respect to Steel Safeguard Measures*, USITC Pub. 3632, 332-452 (Sept. 2003).

to retaliate immediately unless the United States made substantial changes to the tariffs. The EU also commenced appeals at the WTO. During this time, steel prices both in the United States and abroad rose very quickly—by about \$100 per ton.

The United States then began a lengthy process of excluding additional steel products from the remedy. Since March 2002, more than 1000 specific products have now been excluded. While the exclusion process was lengthy and painful for everyone involved, it did have an effect on the EU—it softened the impact of the tariffs enough that the EU agreed to forestall its immediate retaliation. This didn't matter to the U.S. steel industry at all, which simply complained that their remedy had been weakened. (Steel prices did reverse course and start falling, probably due to a combination of causes.) But the fact that a "trade war" was averted did matter a great deal to both the United States and the EU, and to many other industries that might have been swept up in the retaliation.

A WTO panel has already struck down the U.S. steel remedies as contrary to the Agreement on Safeguards and the GATT. The determination is more than 900 pages in length. The panel found multiple flaws with the U.S. measures, for each of the different products involved.

The United States appealed to the WTO Appellate Body. The general consensus is that the United States will again lose. The decision will be completed on or before November 10, and adopted by the Dispute Settlement Body 30 days after that. And the European Union has adopted a regulation that would impose retaliation 5 days after the Appellate Body process is completed.

Even this is hotly disputed. The EU argues that Article 8 of the Safeguards Agreement gives it this right to "rebalance" its WTO concessions immediately. The United States argues that normal dispute settlement procedures should apply, which would give it a reasonable period of time—up to 15 months—to change its laws or modify its earlier decision. All of this will come to a head in the coming weeks.

Finally, the President has discretion to modify, reduce, or eliminate the tariff program. In September, the President received a "midterm review" report on the 201 measures from the International Trade Commission, which analyzed both how the domestic steel industry has used this period of relief, and how steel consumers—and the U.S. economy—have been affected. The Administration is reviewing this midterm report but it has not yet given any indication as to how it might rule.

### *C. Beef Hormone Dispute*

The EU has also suffered its share of "losses" at the World Trade Organization, not to mention difficulty in the implementation of those rulings. One of

the best-known examples of this is the EU beef hormone dispute with the United States and Canada.

The dispute began when the EU banned the use of six growth-producing hormones often fed to cattle in the United States and Canada. In 1998, the WTO Appellate Body found that the EU's ban was not based on a risk assessment, as required by the WTO Agreement on Sanitary and Phytosanitary Measures ("SPS").<sup>6</sup> In particular, the scientific material used by the EU to justify the ban was too general in nature, because it did not specifically evaluate the risks arising from hormone residues in these meat products. After the WTO ruling, the United States and Canada imposed sanctions of about \$125 million.

On October 15, the EU announced that it had complied with the WTO's ruling, by reviewing available scientific evidence and approving a new EU directive on the subject. The EU called this new data conclusive scientific evidence proving the risks and dangers of the hormones, and immediately asked the United States and Canada to lift their sanctions.<sup>7</sup>

The United States has not formally responded, but informally, at least one U.S. official said he was "baffled" by the EU's request. In the United States' view, the WTO struck down the EU's ban because it had never conducted a thorough assessment of risk to humans and animals from the hormones. And, as far as the United States is concerned, there has not been any new risk assessment from the EU. Senator Grassley, chairman of the Committee on Finance, also said, "I don't see anything new here."<sup>8</sup>

#### D. Biotech Products (*Genetically Modified Organisms*)

A similar dispute, one involving "biotech products" (also known as "genetically modified organisms," or GMOs) has been brewing for more than five years, but is just now moving forward at the WTO.

Since 1998, the EU has applied a *de facto* moratorium on the approval of products of agricultural biotechnology—that is, modified corn, soybeans, tomatoes, etc. The EU has suspended consideration of applications for approval of such products, or the granting of such approvals. According to the United States, this has had the effect of restricting EU imports of US agricultural and food products, in violation of the GATT Agreements on Sanitary and Phytosanitary Measures (SPS) and Technical Barriers to Trade (TBT).

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6. EC Measures Concerning Meat and Meat Products, WT/DS26/AB/R, WT/DS48/AB/R, at 244 (Jan. 16, 1998).

7. *EU Urges US, Canada to End Sanctions Over Hormones in Beef*, at <http://www.eubusiness.com/afp/031015140642.1ebfbkgz> (last visited Feb. 5, 2004).

8. *EU Puts in Place New Hormone Legislation, Seeks to Lift U.S. Sanctions*, available at [http://www.insidetrade.com/secure/dsply\\_nl\\_txt.asp?f=wto2001.ask&dh=137067712&q=placeholder](http://www.insidetrade.com/secure/dsply_nl_txt.asp?f=wto2001.ask&dh=137067712&q=placeholder) (last visited Mar. 17, 2004).

The United States argues that it wants a scientific, rules-based process for how these genetically modified foods are assessed. The EU, on the other hand, maintains that it has recently set up regulations to do so. This summer, for example, the European Parliament approved new legislation setting labeling and tracing requirements for food or feed made with GMOs. These new laws could be approved imminently.

The US and EU avoided taking this genetically modified food fight to the WTO for years. However, the United States finally decided that the dispute should be pursued, and has requested the formation of a panel. Some claim that this is a form of U.S. retaliation, in response to the many recent US losses at the WTO, on the Steel, FSC, and other issues. Others see it as the U.S. Government simply caving in to the demands of big agricultural firms in the United States, which want an opportunity to sell these foods and feed in the EU.

#### *E. Other Disputes*

Lest there be any doubt, the list of difficult trade issues between the United States and the European Union goes on and on, including: geographic indications, the WTO "Singapore" issues (trade facilitation, investment, competition policy, and transparency in government procurement); the Byrd Amendment (which pays collected U.S. antidumping duties back to the domestic industry); the 1916 Antidumping Act (a U.S. antidumping statute with antitrust-style remedies of damages rather than antidumping duties); and the OECD Steel subsidy negotiations.

These cases and disputes have proven difficult to resolve, for a variety of reasons:

- the stakes are very high (billions of dollars involved);
- there are factors other than mere trade issues involved (political, cultural);
- the United States and the EU have very different regulatory and political systems, which complicates the ability to change our laws after a WTO decision; and
- WTO implementation is not a straightforward process. The bigger the case, the more it becomes a protracted negotiation, rather than an implementation.

### III. PROSPECTS FOR RESOLUTION

With all of these storm clouds looming on the horizon—and some even directly overhead—are there reasons for optimism? Yes, absolutely.

First, the art of compromise remains. The United States and the EU understand the importance of this trade relationship, and they will preserve it if

at all possible. Consider the ongoing FSC dispute, where \$4 billion in retaliatory tariffs hang in the balance—what Ambassador Zoellick has likened to a “nuclear bomb” in the world trade system. Again, the rhetoric has been harsh. But both sides appreciate the gravity of the problem. And, according to an article earlier this week in the *Wall St. Journal*, the EU is now considering how it could impose these sanctions gradually, rather than all at once. This approach, according to the *Journal*, “indicates how much the EU wants to avoid a full-scale trade crisis with Washington.”<sup>9</sup>

The historical evidence is mixed. Several major trade disputes have been resolved successfully: wheat gluten, bananas, and others. But the process often takes a great deal of time. Others, such as FSC, the Byrd Amendment, and the 1916 Act, are still unresolved, years after the original WTO ruling. My colleague, Hunter Clark, has written extensively about the bananas dispute, and he calls that outcome “a small but good and significant exception to the overall decline in American-European relations.”<sup>10</sup> I would characterize the case somewhat differently—not as the exception but as the rule, at least in trade relations. The US and the EU seem to have been able to resolve their trade differences in the past—even on big cases, but not without long periods of posturing and rhetoric.

A second reason for optimism is a related one: the leadership and the relationship of Ambassadors Zoellick and Lamy. I do not personally know either of these gentlemen. But, it is widely known that these two ambassadors have been friends, and marathon runners, for a number of years, dating back to the diplomatic efforts that led to the reunification of Germany. At that time, Lamy was chief of staff to Jacques Delors, president of the European Commission. Zoellick was counselor to Jim Baker, the U.S. secretary of state.

And so, perhaps it is not surprising that just before a critical G-7 conference, at a point when the WTO negotiations needed a jumpstart back in the summer of 2001, Ambassadors Lamy and Zoellick wrote a joint editorial in the *Washington Post*, where they emphasized, “We have a shared responsibility for the international economic system . . . As the two biggest elephants in the global economy, the EU and the United States need to get our act together on trade.”<sup>11</sup> And, just months later, the Doha Development Round of trade negotiations was launched.

Ambassadors Zoellick and Lamy have found a way to work together on trade, even during a period where our broader diplomatic relations have suffered

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9. Matthew Newman, *EU May Impose Sanctions on U.S. Gradually*, *WALL ST. J.*, Oct. 21, 2003, at C15.

10. Hunter R. Clark, *The WTO Banana Dispute and Its Implications for Trade Relations Between the United States and the European Union*, 35 *CORNELL INT'L L.J.* 291(2002).

11. Pascal Lamy & Robert B. Zoellick, Editorial, *In the Next Round (U.S.-EU Trade Issues)*, *WASHINGTON POST*, July 17, 2001, at A17.

and been questioned. So it is not surprising that with several of the trade disputes described above now reaching their boiling point, Ambassador Lamy will be visiting Washington in less than two weeks. On his agenda, publicly, is the FSC dispute. And, I am willing to bet, on his agenda—whether or not publicly, is the steel 201 dispute.

The United States and the EU have worked very closely on several key WTO issues. They worked together in 2001 to launch the Doha Round. Now, the biggest question is whether they will meaningfully address the biggest single obstacle to the negotiations—the question of agricultural subsidies. The two parties made a common proposal just before the Cancun ministerial, although it was rejected by developing countries and in part overshadowed by other issues at Cancun. And before that, the US and EU made another similarly bold proposition: the removal of all tariffs on all industrial goods by the year 2015. Notably, we saw a fairly significant split of interests, not between the United States and the EU, but instead a North-South split, with the United States and the EU on one side, and the so-called G-21 developing countries on the other. If the United States and the EU want to show leadership, they will need to work together to do more than they have done to date, on agriculture and on other important issues.

#### IV. CONCLUSIONS

##### A. *Has there been a fundamental change in U.S.-EU trade relations?*

Despite the many obstacles, which are formidable, the United States and European Union still have a strong working relationship on trade issues, thanks in large part to their common interests, the efforts of Ambassadors Zoellick and Lamy and their respective agencies. There are some who see the broader U.S.-EU diplomatic relationship as moving apart, and in some areas, that may be true. But in the area of trade, I think there is little evidence of a weakening relationship. At least, not yet.

We could well be engaged in an all-out trade war on any of the trade issues described above, but we are not. If anything, I think the United States and the European Union will look to collaborate even more on trade negotiations at the WTO, particularly given the emergence of the G-21 countries at Cancun.

However, the United States is pursuing other trade alliances as well, including a long list of bilateral free trade agreements, which seem to be moving very quickly recently, and the Free Trade Area of the Americas, where the outcome is somewhat more uncertain. The European Union is doing the same thing. It is too early to say whether these other efforts will overshadow the multilateral WTO talks. Another potential concern is whether the United States will use free trade agreements to drive its political objectives (for example, by concluding FTAs only with its allies on Iraq).



*B. Is U.S. trade policy increasingly driven by unilateralism?*

A law professor at George Mason University, for example, recently wrote that the United States' filing of the GMO case "evidences a growing U.S. tendency to rely upon power politics and unilateral intimidation at the expense of diplomatic and multilateral efforts."<sup>12</sup> I disagree.

This may be true, unfortunately, of U.S. foreign policy, but it is not true of U.S. trade policy. The GMO case, at least to me, is an example of the U.S. Government trying to open an overseas market that is currently closed. The question is whether the reason why the market is closed is a valid, scientific one, or not. This is a reasonable question, given the WTO Agreements, and a legitimate subject for a Panel to consider.

The most unilateral trade action taken by the U.S. Government recently has been the Steel 201 safeguards. But the WTO does grant Members the right to take such action in the appropriate circumstances, as limited by the Safeguards Agreement. Neither the Steel 201 nor the GMO cases demonstrate any real trend toward unilateralism in trade policy. The greater danger is that U.S. frustration with the WTO dispute settlement process might weaken U.S. support for the WTO as a whole. But we have not yet reached that point.

The U.S. safeguard measures were imposed only after a period of serious injury to the domestic industry, after a unanimous finding of serious injury at the ITC, and after an extensive review process by the Administration. (In fact, the EU enacted its own such measures, shortly after the U.S. remedy was announced.) So I think it is easy, but incorrect, to simply say that the Steel 201 was protectionist and wrong, without any further analysis.

Certainly, on Iraq and on other international issues, there is a strong argument that the Bush Administration has pursued unilateralism over diplomacy and consensus. And there are deep cultural and political values that underlie today's trade disputes, which in some ways continue to drive us apart. But the United States has not abandoned the goals of free trade and a multilateral trading system, or its main partner in achieving those goals, the EU.

#### V. POSTSCRIPT (DECEMBER 2003)

Since this speech in October, one of these critical disputes has been resolved. On December 4, 2003, President Bush signed a proclamation terminating the U.S. steel safeguard measures, ending the tariff relief 15 months early. The President took action only six days before the scheduled implementation of retaliatory tariffs by the EU, Japan, and other nations. This action

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12. Stuart S. Malawer, *Put Down the Genetically Modified Tomatoes: It's No Time to Pick a Trade Fight Over Biotech Foods*, LEGAL TIMES, Sept. 1, 2003, at 44.

was welcomed by the United States' trading partners and in particular by the European Union, which removed its own safeguard measures the next day.

The steel safeguard saga arguably confirms this paper's general thesis: the United States and the European Union will find a way to resolve their trade disputes, but often only at the last possible minute, after other legal and political options are exhausted, and after unfortunate but expected posturing and rhetoric. (In the steel case, however, the U.S. Government's endgame rhetoric was uncharacteristically muted.) While many other seemingly intractable trade challenges await, one should not underestimate the ability of the United States and the EU to resolve them—without resort to “trade wars” or a downward spiral toward unilateralism.