

Ties that Bind: the European-American Economic Relationship

By John Ross*

With nearly \$1.2 billion worth of trade in goods and services crossing each other's borders everyday, the economies of the United States and the European Union are deeply interwoven. Such a figure is a much-needed and grounding testament to the continued strength of the U.S. alliance with Europe. As hostile political rhetoric flies across the Atlantic over the war in Iraq and the larger issue of U.S. right to act unilaterally in global affairs, the interdependency of the economies serves as ballast. The fact is that the two powers need each other. Selling products in transatlantic markets means increased profits for companies and higher employment levels. Increased competition from abroad means that the labor and resources used in production are allocated as efficiently as possible, encouraging innovation and eliminating waste. Where US firms can offer higher quality goods and services at a lower price to European consumers than European firms can (and vice versa), consumers reap the benefits. This system works only when both sides participate in good faith. Protectionist policies in the form of subsidies, tariffs, and overregulation that hinder free trade ultimately hinder mutual attempts at prosperity. This paper analyzes the current state of the transatlantic economic relationship, institutions that facilitate it and challenges it faces.

Trade between the US and Europe

The US and the EU are each other's largest trading partners, accounting for one-fifth of total trade on each side of the Atlantic (Bilateral Trade Relations). In 2002, both partners accounted for 21% of the other's cross-border trade in goods (\$492 billion)—20% of which was estimated to be in high-technology products. Additionally, the US represents 39% of EU trade in services, and the EU represents 35% of US trade in services (\$284 billion).¹

At \$1.2 billion a day, EU-US trade is robust. In 2002, EU exports to the US reached \$286 billion (24.2% of its total exports) and EU imports from the US reached \$209 billion (17.7% of total imports).²

Role of the World Trade Organization

Perhaps the most important international organization that oversees international trade, the World Trade Organization (WTO) is actively used as a third-party mediator in trade disputes of all kinds. When conflicts arise and member governments are unable to reach a settlement on their own, one or both governments often file a complaint with the WTO. The WTO has an arbitration process to determine whether a country's trade rules are consistent with international law adopted at the creation of the WTO in 1995 and in

keeping with prior obligations to the WTO's predecessor the Generalized Agreements on Tariffs and Trade (GATT).

The WTO, made up of 146 member states, is mandated to streamline the economic policies of its members to promote free trade. These members engage in intense negotiations to determine new rules with the overall aim of reducing protectionist measures (subsidies, dumping laws) while attempting to nurture and allow for the development of emerging economies.

When a country or a group of countries believe another country's trade policies unfairly restrict their companies from doing business under rules agreed upon by all, they may file a suit with the WTO. After a thorough arbitration process, the WTO decides the merits of the case and may allow the complainant country to impose pre-determined countermeasures.

The WTO maintains that free trade and open markets are the best option available for fighting poverty. Once corporations have entered a country, they create a demand for business savvy, multi-lingual workers and a stable rule of law to protect their investments. Development, while unequal, is reaching some of the world's poorest areas and hopefully creating a larger global awareness of industry and free trade.

Recent Trade Conflicts

The United States and the European Union, however, mainly use the WTO to settle bilateral trade disputes. The US filed grievance in 1996 with the WTO over EU policy restricting the sale of genetically modified foods in its markets.³ Agricultural subsidies also remain a contentious issue for the next round of trade talks as will be discussed below. Recently, the EU has appealed to the WTO over US government subsidies to the steel industry (on which the US has backed off) and won the right to levy \$4 billion in tariffs to offset subsidies given to US companies under the Extraterritorial Income Exclusion Act. Also the practice of Zeroing has provoked a word of protest from the EU.

Genetically Modified Foods

The US, which produced two-thirds of the world's biotech crops in 2001, has long taken issue with an EU ban on the import of new products that make use of biotechnology. Calling the moratorium an unfair hindrance to free trade, the US, along with several other countries, has gone to the WTO and contested the EU's assertions that Genetically Modified Organisms (GMOs) present a health risk.

The EU points to controversy within the scientific community as to whether GMOs pose a health risk. While the European Commission admits that it has not found any real dangers thus far, it argues that more testing must

be done and claims that it is merely taking precautionary measures to protect its consumers.⁴ The US and others, including Canada, Argentina, and Egypt, fault the EU for failing to provide a transparent risk assessment process to determine potential harm caused by GMOs.⁵

While the US claims that such developments are more the result of the European political process than of an analysis of scientific evidence, EU Commissioner Pascal Lamy argues that Europe has weathered mad cow disease, foot and mouth disease, and a blood contamination scandal in recent years and that its populace is therefore more inclined to see risk in genetically engineered food and have a lower tolerance for that risk.⁶

Robert Zoellick, the US Trade Representative (USTR) and chief US policymaker in this area, is a strong supporter of GMOs. Scientists have discovered how to grow crops more resistant to disease that drastically reduce soil erosion and the amount of pesticides used, thus decreasing the negative effects of the agriculture industry on the environment. Also, scientists have discovered how to increase the nutritional value of certain staple foods and how to increase food production per acre.

Zoellick argues that GMOs are in fact safe, citing research by the EU's own Directorate-General for Research and scientific academies in the UK, France, the US, Brazil, China, India, and Mexico. He has demanded prompt action on the part of the EU to lift the moratorium. Some EU commissioners, who are responsible to Member States, have been willing to promote such legislation, but their efforts have been stonewalled largely as a result of public misgivings and even fear—justified or not.

Alternative measures, such as labeling products with GMOs that allow consumers to decide which product they prefer, have drawn widespread support—86 states and the EU recently signed an agreement to increase labeling requirements on such products. The US has not endorsed the new measures, part of the UN Cartagena Protocol, and insists that the labels will disrupt international trade because exactly what is to be labeled is as yet unclear.⁷

Exporters of GMO foods will most likely oppose the labels as well because labeled products seem riskier giving them a competitive disadvantage. The revenue of an individual consumer will also likely determine whether one purchases a GMO or non-GMO foodstuffs because prices for GMO products will likely be lower as they hit the new market and will attract lower income consumers. Thus, the purchase of these foods will not indicate an overall consumer assessment of risk as much as a reflection of socio-economics.⁸

EU policies affect more than just US exporters. Many exporters from developing countries, which desperately need trade revenue, refuse to grow and use biotech crops because they would then be unable to sell their products in Europe. Zoellick charges that the EU's unfounded concerns over GMOs are stoking fears worldwide about the safety of biotech products and laments that countries such as India and China, which could benefit from biotechnology, are following the EU's lead.⁹

In 1999, the WTO found the US case more convincing and authorized the US to impose 116.8 million in retaliatory tariffs to offset losses to US exporters of beef treated with growth hormones on the grounds that EU policies conflict with the Sanitary and Phytosanitary Agreement—the basic rules of food safety standards which came into force with the creation of the WTO in 1995.¹⁰ Currently, the EU is defending its six-year moratorium on new GMOs in the WTO. The US maintains that the ban is little more than a subsidy for EU agriculture—by shielding European farmers from US competition they hinder free trade.¹¹ Curiously, at the present time, European producers of genetically modified seeds are invading US markets at home.

Agriculture Trade

As members of the WTO prepare for the next round in the Doha negotiations, USTR Robert Zoellick has moved to place the cessation of farm export subsidies first on the agenda. Arguing that the success of the new talks depend firmly on the EU's willingness to end payments to its agricultural exporters, Zoellick has urged Brussels to recommit itself to free trade. The EU opposes the assertion that ending EU "farm export subsidies is the only precondition for the success of the talks" and further argues that US food aid export credits (export subsidies disguised as foreign aid) and exporting monopolies in Australia, Canada, and New Zealand are also major issues of concern.¹²

Having proposed to cut \$100 billion in domestic subsidies before the unsuccessful Cancun talks, the US is urging the EU to follow its lead this time.¹³ Rejecting the implicit assertion that the EU bears a greater degree of responsibility to reduce agricultural subsidies, EU Trade Commissioner Pascal Lamy pointed out that only 10% of developing countries' exports are agricultural and that the EU imports more of them than the US, Canada, Japan, and Australia combined.¹⁴

To prepare for the next round, the EU has tabled a proposal that would, if passed, reduce its global export subsidies by 45%.¹⁵ The EU has also proposed to eliminate export subsidies on a list of commodities of interest to trade partners in the developing world but claims there have been no specific requests from the Asia Pacific Caribbean (ACP) group to eliminate any subsidies. These developing states, mostly former colonies of EU Member States, have a preferred trader status with the EU.¹⁶

As both the EU and the US heavily subsidize their agricultural producers to the detriment of free trade and producers across the globe, agriculture will likely remain a serious concern in trade politics for some time. Indeed, the agricultural sector on either side of the Atlantic has tremendous internal influence on the political process. Opposing free trade and the foreign competition it will bring, agricultural concerns and advocates of open markets

are at odds and domestic consensus on agricultural issues is unlikely to be reached in the near future in the EU or the US.

Steel

In March 2002, President G.W. Bush imposed tariffs ranging from 8% to 30% on ten groups of foreign steel products after the US International Trade Commission concluded that global overcapacity in the steel sector was spurring import surges harmful to US steel makers. In placing these “temporary safeguards” against foreign competitors, President Bush sought to allow domestic producers time to restructure in order to increase their productivity and lower costs.¹⁷

Propped up by bankruptcy payments meant to assuage the negative social effects of massive layoffs, the US industry has been partially shielded from the restructuring that has cut half of the jobs in the European steel sector over the last 20 years. In this light, it seems unlikely that recent import surges are to blame for the multi-decade decline of US steel.¹⁸

Widely criticized at home and abroad, the tariffs are the classic example of protectionism. With an overabundance of steel producers on the world market—meaning supply far exceeds demand—producers are forced to reduce their prices and lower output. Already a troubled sector, the US steel industry could not compete with foreign firms that had lower production costs. In the attempt to help US steel, the tariffs had the effect of raising prices on foreign steel to a level with which domestic producers could compete.

This policy had a negative effect. Higher steel prices mean higher costs to consumers of steel; namely US auto and appliance makers. The tariffs merely passed off costs arising from inefficiency in the domestic steel industry to other industries. Also, many in the US charged the Bush administration with pandering to steel interests in West Virginia, Ohio, and Pennsylvania to consolidate support for Republicans in the upcoming Presidential elections.

Foreign governments criticized the tariffs as an unfair restriction on free trade. The EU, which has five of the world's ten largest steel companies, appealed to the WTO, which ruled that the US was in violation of its trade obligations. In December 2003, the tariffs were lifted—fifteen months earlier than the administration had planned. Officially, they were repealed because they were a resounding success—layoffs declined and the administration claims the industry had successfully restructured. There has been some skepticism over the veracity of that claim, however, as the EU was just days away from imposing retaliatory tariffs designed to affect industries in states important to the upcoming election—such as the citrus industry in Florida. While EU efforts to influence US policy were very effective in this instance, the EU has not had as much success in other areas.

Zeroing

Another dispute involving anti-dumping revolves around the US practice of zeroing “when performing its dumping calculations” to determine how much foreign firms should pay in duties for dumping on US markets.¹⁹ When calculating how much dumping is occurring on its markets, the US compares weighted prices of commodities from foreign firms. Where those prices are lower than the prices those firms charge on their home markets—dumping—the US records it. But where those prices are higher than on their home markets, the US does not record it and the cumulative balancing effect of the lower and higher prices is ignored.²⁰

This is called zeroing and the EU, which has used the zeroing methodology in the past, claims that a previous case brought to the WTO by India explicitly condemns the use of such methods. Rebuked in the India-Bed-Linen case, the EU now argues that US zeroing practices are a violation of WTO norms. The EU argues that US zeroing is unfairly penalizing many European exports, including steel, ball bearings, pasta, and chemicals. Further, the EU charges that the US government illegally collects duties from foreign firms, which are then used directly to subsidize US interests by right of the Byrd Amendment.

Boeing-Airbus

The most recent and by far the largest dispute to break out on either side of the Atlantic in terms of its implications regarding the legality of government subsidies to important industries, is the Boeing-Airbus conflict, which threatens to further escalate US-EU tensions.

On Wednesday October 6th, 2004 the US opened an inquiry with the WTO, claiming that European governments had spent \$15 billion in illegal subsidies to Airbus—a European aerospace consortium and competitor of the US’ Boeing Company. The EU immediately charged that the US government had illegally channeled \$23 billion towards Boeing, mostly in the form of research and development. There is little doubt that both sides have been subsidizing in one form or another. What remains unclear is why the US administration has decided to declare an end to the tacit agreement with Brussels to turn a blind eye to subsidies in the aerospace industry.²¹

Under WTO rules, each side must spend October and November in negotiations to try and resolve the conflict. This could result in another bilateral agreement to restrain subsidies—much like the one that had been in effect since 1992. If the US and EU cannot come to a mutually acceptable arrangement and do not decide to lengthen the period of discussion, the WTO’s dispute settlement panel will form. In that event, one can expect that both US and EU subsidies will be declared illegal—much like the 1996-

1997 dispute between Canada and Brazil in which each sides' subsidies to their aircraft industries (Bombardier and Embraer, respectively) were found in breach of WTO accords. Though each side was given authority to sanction the other, neither side did so, fearing the loss of profitable bilateral trade; nor was either side willing to end their subsidies and eight years later the dispute still exists.²²

Policies and Laws in Dispute

The Byrd Amendment or the Continued Dumping and Subsidy Offset Act of 2000 (CDSOA)

According to the EU, the Byrd Amendment, signed into law in the US in October 2000, constitutes illegal government subsidization of industry under the guise of punishing foreign companies for dumping on US markets. The law grants payouts to US companies that complain successfully that foreign competitors are dumping.²³

In January 2002, the first annual distribution of funds collected under the CDSOA was \$231 million—mostly to steel producers. A year later, \$330 million was distributed. Half of that total went to only three companies.

Arguing that such payments are illegal under WTO rules, which state that duties levied on foreign “dumpers” must fill government coffers, the EU and other states filed a grievance with the WTO in December 2000 charging that the payments are illegal subsidies. After ruling in favor of the EU, the WTO granted the US until December 2003 to repeal the amendment.²⁴

Though the Bush administration has attempted to rally congressional support against the CDSOA, efforts to repeal it have failed thus far. With the deadline for compliance having come and gone, the EU and seven other countries (including Canada and Japan, other major US trading partners) have asked the WTO for the right to impose sanctions on US exports. While the Bush administration continues to try to persuade Congress to alter the provisions of the Byrd Amendment, the EU request is working its way through the WTO arbitration process. However, it is not the only US policy that President Bush is trying to make WTO-compliant.

1916 Act

When a firm sells its products in a another market at a price drastically reduced from that which it charges at home or when it sells below production costs to the detriment of its competitors, that firm is said to be “dumping.” Though tolerated to a certain degree, the extent to which dumping is acceptable is a source of constant debate in transatlantic economic relations.

The nature of this dispute is not over dumping itself but whether the 1916 Act in the US, which imposes penalties on exporters who dump their products on US markets, is consistent with WTO anti-dumping legislation. "Violators" of the 1916 Act can be fined and even imprisoned.²⁵

In March 2000, the WTO ruled in the EU's favor that the 1916 Act does not conform with the Generalized Agreement on Tariffs and Trade, a precursor to the WTO that is still in effect, because it does not "provide a number of procedural safeguards" for potential offenders. When the US failed to conform to WTO standards by December 2001, the WTO granted the EU authorization to apply countermeasures equivalent to those imposed by the US. But the EU requested the right to impose roughly three times the damages on American "dumpers" that the US had imposed on European "dumpers." The US objected, and after a WTO arbitration process the EU's proposal was rejected.

The Office of the US Trade Representative expresses hope that the 1916 Act will be repealed. Legislation is pending in both the US Senate and House of Representatives, so the conflict may resolve itself. The EU nonetheless has its concerns. Two out of the three bills working through Congress "would leave ongoing litigation unaffected." Regarding such US legislation, which would not "terminate" existing cases involving foreign firms in violation of the 1916 Act, the EU may yet have objections.²⁶

Foreign Sales Corporation Tax (FSC)-Extraterritorial Income Exclusion Act (ETI)

Potentially the most damaging conflict to transatlantic commerce, the dispute over the US FSC Tax rules, has not been resolved. In February 2000, the WTO ruled that the FSC, "legislation that provides that certain income earned by a foreign subsidiary of a US corporation would not be subject to US tax," represents an illegal trade practice because it, in effect, subsidizes exports.

In November 2000, President Clinton signed the Extraterritorial Income Exclusion Act (ETI), which replaced the FSC, into law. The text of the new law did not adequately modify FSC. Following a complaint from the EU, the WTO's appellate body again ruled that US policy had disobeyed international agreements.²⁷

In May 2003, following WTO approval to levy \$4 billion in retaliatory measures, the EU set a March 1, 2004, deadline for the US to conform to the ruling so as to allow US lawmakers time to adopt the appropriate legislation. The deadline was not met, however, and the EU imposed a 5% duty (or increase on duties already existing) on selected products including roller skates, natural honey, refrigerators, tomatoes, suits and pants. These duties will increase 1% per month of US non-compliance until they reach a ceiling of 17%.²⁸

Positives From US-EU Relationship

Cross-Atlantic Investment

One important aspect of the transatlantic economic relationship is foreign direct investment (FDI). Investment flows are substantially greater than trade, and by 2001 total cross-investment stocks had reached \$1.5 trillion (on historical-cost basis)—by far the world's largest bilateral investment partnership.²⁹ American and EU companies are now more likely to produce their goods and services through foreign affiliates across the Atlantic than they are to export across borders. Furthermore, American and European countries invest more in each other than anywhere else in the world.

With each economy employing four million workers in the other country, the US/EU economic relationship is highly advanced but also well balanced. In 2001, the EU and the US each represented 49% and 46% respectively of each other's FDI outflows. 54% of US total inflows came from the EU and 69% of EU total inflows came from the US. Both each other's largest investors, 46% of US FDI stock is in the EU, and 50% of the EU's investment assets abroad are in the US. Accounting for 67% of world total outflows and 54% of world total inflows, the EU and US are the largest source and destination for FDI in the world.

This investment relationship, while it receives less media attention than the recent political conflict over Iraq and trade disputes over GMOs and steel among others, reflects our continued interdependence with Europe and provides justification to continue to search for diplomatic means to resolve our differences so as not to disrupt our mutually profitable commerce.

Multinational Corporations (MNCs) in US-European Economic Relations

European and American companies, which are increasingly conducting their business through affiliates on the other continent rather than manufacturing domestically and shipping their products across borders as exports, play a major role in transatlantic economic relations. "The total output of US foreign affiliates in Europe (\$333 billion in 2000) and of European foreign affiliates in the US (\$301 billion) is greater than the total gross domestic product of most nations."

Another measure displaying how American and European corporate connections have grown increasingly intertwined are the sales figures for American subsidiaries operating in Europe which reached \$1.4 trillion in 2000—half of total global US foreign affiliate income. By comparison, "US affiliate sales in China totaled \$32 billion." US affiliate sales in Germany and

France, main opponents in the UN over the war in Iraq, totaled \$236 and \$137.5 billion respectively.

In addition, US subsidiaries directly employed 4.1 million Europeans in 2000. In the same year, European firms employed 4.4 million Americans (out of a total of 6.4 million US workers on foreign payrolls). European affiliates also, on average, offer higher wages and benefits to US workers than domestic firms.

Streamlining Regulation

With so much commerce being conducted on foreign turf, US and EU companies are directly affected by regulatory policies on the opposite shores. Appropriately, US and EU regulatory agencies have been working to streamline rules for corporate accounting and oversight. As differences in policy can lead to burdensome increases in the cost of doing business on both sides of the Atlantic, the US and EU maintain an active dialogue in efforts to resolve regulatory overlaps and lapses.³⁰

In June 2002, the EU mandated that corporations operating within its borders follow International Accounting Standards (IAS) and abandon the 15 separate national standards by 2005 as part of the establishment of a common market by 2005. Firms operating in the US, however, have been held to Generally Accepted Accounting Principles (GAAP) since the May 2002 Sarbanes-Oxley Act. Requiring "all firms that perform audits on companies publicly listed in the US" to conform to a "registration, inspection and investigation regime," the Sarbanes-Oxley Act drew fire from European auditing firms and the EU finance minister who complained that high costs of compliance and conflicts between GAPP and IAS were unnecessary hindrances to business.³¹

The US—which imposed the stringent Sarbanes-Oxley Act in response to several massive accounting scandals at US companies such as Enron and WorldCom—and the EU have taken steps to resolve the dispute and have agreed to conduct shared investigations into future corporate fraud cases.³²

In 1998, after negotiations and an internal approval process from both sides, the US and the EU implemented the Mutual Recognition Agreement (MRA). Covering \$48 billion of trade a year and estimated to save \$238 million a year, the MRA seeks to reduce overlapping control and bolster transparency in regulatory procedures to reduce entry barriers in six sectors: telecommunication equipment, electromagnetic compatibility, electrical safety, recreational craft, medicinal products, and medical devices.³³

Aspects of regulation that differ in the US and EU, competition policy and intellectual property rights also remain important regulatory issues. Microsoft, having dealt with a US Department of Justice anti-trust inquiry in recent years, has just lost a case with the European Commission that cites the company for monopolistic practices. Europe's competition commissioner,

Mario Monti, fined Microsoft \$602 million. Microsoft is appealing the case, and USTR Robert Zoellick has become involved, appealing to EU trade commissioner Pascal Lamy to ensure that the ruling will be in accord with WTO intellectual property rights provisions.³⁴

Both the EU and the US acknowledge the necessity of streamlining their rules because "differences in regulatory policies affect the entire spectrum of transatlantic economic activity, hindering not only the free movement of goods, but also the provision of services and the growth of investment (including mergers and acquisitions)."³⁵

Current Status of the Transatlantic Economic Relationship

While the US to date has failed to comply with five WTO rulings and the EU hasn't complied with one, the partnership remains strong. And though these trade disputes steal the headlines, trade itself accounts for less than 20% of overall transatlantic commerce. With so much direct investment, corporate activity, and employment taking place across the Atlantic, both parties remain eager to minimize headline-stealing conflicts and make progress reducing regulatory conflicts, development and competition policy and to reduce tariffs in their quests for freer markets.

Future disputes could arise over regulation of chemicals and geographic indicators. The EU has proposed that the manufacturers of 30,000 substances register their products and prove that they are safe. The US Secretary of State has sent a memo to European commissioners and diplomats expressing concern that such regulation would be excessive, if not impossible to implement.³⁶ The US also complains that EU requirements that all WTO members have systems equivalent to its own to ensure that products have labels indicating their geographic place of origin are unworkable because the EU's own requirements for labels are not clear.³⁷

While a host of other trade and regulatory policies remain possible sources of conflict, many agreements are being made. This February, EU trade commissioner Pascal Lamy, Irish Ambassador Noel Fahey, and USTR Robert Zoellick signed the US-EC Marine Equipment MRA. Covering 43 products in three main categories—life saving equipment, fire protection equipment, and flame retardant materials—the MRA obligates each side to accept the others safety and quality tests. Henceforth, a lifejacket certified fit for use by the US Coast Guard will be acceptable to EU consumers without costly additional safety tests (and vice versa). The MRA covers approximately \$150-200 million of trade per year but leaves the door open for expansion to include the entire industry which conducts \$1 billion a year in two-way trade.³⁸

Conclusion

As the tenure of EU trade commissioner Pascal Lamy draws to a close and the departure of the USTR Robert Zoellick appears imminent, new characters will become the guardians of the transatlantic trade relationship. We can expect that even in the face of recent political conflicts over US "unilateralism" and headlines declaring imminent transatlantic trade wars, the US-EU economic relationship will remain solid under the stewardship of incoming EU commissioner Peter Mandelson and an as-yet unnamed official from President Bush's cadre. Though many challenges have yet to be tackled in the ongoing quest for free trade, both sides maintain an active dialogue in order to streamline regulatory policies and reduce subsidies and promote competition. Using the WTO as both a forum for discussion and a third party to rule on disputes, the EU and the US continue to move in the same direction with the same faith that open markets will lead to greater opportunity and prosperity for humankind.

Notes

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All Euros to Dollars conversions using: <http://www.x-rates.com/calculator.html>

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