

*The Future
of Transatlantic
Economic Relations*

Continuity Amid Discord

edited by

David M. Andrews

Mark A. Pollack

Gregory C. Shaffer

Helen Wallace

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FOR EUROPEAN STUDIES
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Edited by

**David M. Andrews, Mark A. Pollack,
Gregory C. Shaffer and Helen Wallace**

**The Future of Transatlantic Economic Relations:
Continuity Amid Discord**



**European University Institute
Robert Schuman Centre for Advanced Studies
Florence, Italy**

82076

327.4073
327.7304

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ISBN 92-9084-010-2



Published by the Robert Schuman Centre for Advanced Studies
European University Institute
Via delle Fontanelle, 19
I - 50016 San Domenico di Fiesole (FI), Italy
<http://www.iue.it/RSCAS/>

Printed in Italy, in July 2005

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The Transatlantic Programme was established in Autumn 2000, thanks to a generous grant from BP.

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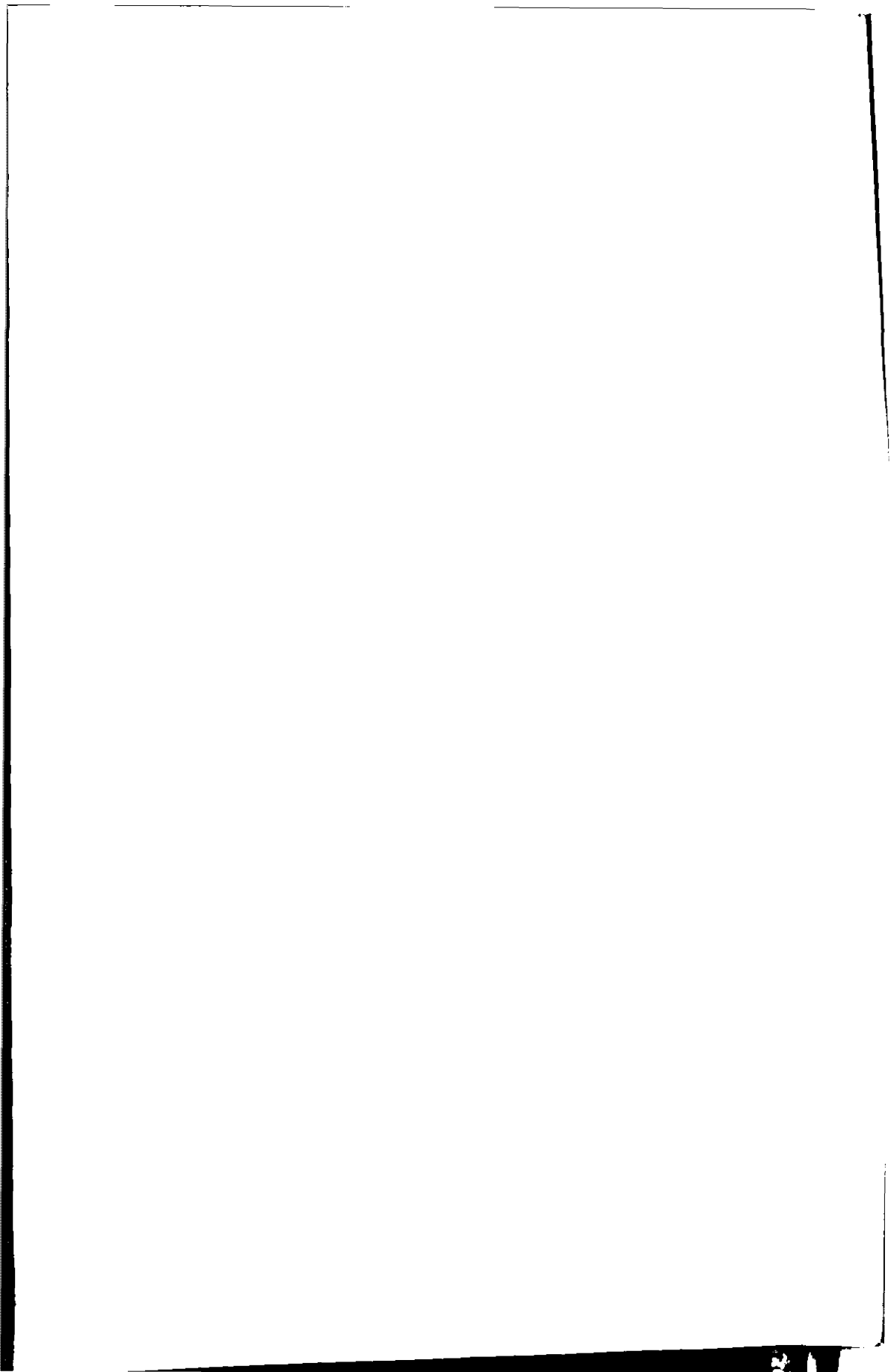
Via delle Fontanelle, 19

50016 San Domenico di Fiesole (FI), Italy

Fax: + 39 055 4685 770

E-mail: atlantic@iue.it

Website: <http://www.iue.it/RSCAS/Research/Transatlantic/>



List of Contributors

David M. Andrews, Co-editor
Scripps College

María Green Cowles
American University

David J. Gerber
Chicago-Kent College of Law

Daniel S. Hamilton
Johns Hopkins University

Christian Joerges
European University Institute

William E. Kovacic
George Washington University
Law School

Kalypto Nicolaïdis
Oxford University

Hugo Paemen
Georgetown University

María Verónica Pérez Asinari
University of Namur

Ernst-Ulrich Petersmann
European University Institute

Mark A. Pollack, Co-editor
Temple University

Elliot Posner
George Washington University

Yves Poullet
University of Namur

Joseph P. Quinlan
Johns Hopkins University and
German Marshall Fund

Gregory C. Shaffer, Co-editor
University of Wisconsin

Rebecca Steffenson
Queen's University Belfast

Bruce Stokes
German Marshall Fund

Helen Wallace, Co-editor
European University Institute

Sir Nigel Wicks
Euroclear plc.

Stephen R. M. Wilks
University of Exeter

Alasdair Young
University of Glasgow



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Part I

**The Transatlantic Trade and Investment Environment:
Continuity Amid Discord**



Introduction

**The Future of Transatlantic Economic Relations:
Continuity Amid Discord**

Mark A. Pollack
*Gregory C. Shaffer**

From 2000 through 2004, transatlantic political disputes intensified over the establishment of an international criminal court, the status of the Kyoto Protocol on climate change, the US conduct of the war on terror, and the war in Iraq, among other matters. High-level officials in the United States (US) spoke of “punishing” France and “ignoring” Germany. Not only pundits, but business leaders feared that the acrimony over political and security matters could spread to the economic realm. Ad hoc boycotts were organized against French wines in the United States and US products in Europe. Disputes escalated over steel tariffs, agricultural subsidies, aircraft production subsidies, tax subsidies, consumer, food safety, and environmental laws and regulations. The various transatlantic dialogues among “civil society” groups, which had been established during the 1990s to spur public participation in the transatlantic sphere, lost momentum. Had the hopes of a “new world order” underpinned by the transatlantic alliance faded away? Would the economic side of the 1990’s “New Transatlantic Agenda” (“NTA”) wither from neglect?

* Names appear in alphabetical order. This introduction, like our previous work, represents an equal and ongoing intellectual partnership.

These developments marked a stark contrast to the hopes triggered by the end of the Cold War and the initial enthusiasm raised by economic globalization during the early and mid-1990s. In February 1990, the United States (under the first Bush administration) signed a Transatlantic Declaration with the European Union (EU) which promised "regular and intensive consultation" on wide-ranging policy matters. In December 1995, the Clinton administration and the European Commission followed-up by signing the New Transatlantic Agenda, which provided a framework for economic and security cooperation at all levels of government. In the economic realm, the NTA called for an elaborate multi-tiered network of cooperation among US and EU officials designed to govern and facilitate the growing transatlantic marketplace. In order to foster a closer relationship at the grassroots level, the NTA also worked to "build bridges" across the Atlantic between "business people, scientists, educators and others."

Alongside the traditional processes of trade negotiation and trade dispute resolution, the transatlantic partners forged new mechanisms for cooperation among economic regulators in areas ranging from competition policy to data privacy, the environment, and food safety. By the end of the 1990s, the US and the EU had concluded "mutual recognition agreements" ("MRAs") in six regulatory sectors, including the fields of telecommunications, electrical safety, medical devices, and pharmaceuticals. They also signed agreements to enhance the compatibility of their regimes for cross-border mergers and acquisitions, privacy protection, and veterinary inspections, among other matters. They entered into a new framework agreement for regulatory cooperation and proposed an "early warning" system to avoid trade disputes. They advocated greater day-to-day cooperation in an array of regulatory areas.

Yet despite the initial hopes, by the end of the 1990s, both sides had become disappointed with the NTA's results. In the view of many participants, the "low-hanging fruit" of economic cooperation had been picked. Governments on both sides now found it increasingly difficult to move beyond symbolic agreements and rearguard efforts at conflict resolution. Enhanced cooperation among regulators had not prevented new and bitter trade disputes from arising. The transatlantic political conflicts that arose at the twenty-first century's start boded poorly for the economic relationship, raising the question whether the New Transatlantic Agenda had run aground after less than a decade.

This volume probes beneath transatlantic political conflicts to assess the health of the transatlantic economic relationship and of the networks of regulatory cooperation established during the 1990s. It focuses our attention on the largely underappreciated economic side of the transatlantic relationship, and covers an array of sectors. The contributors include leading academics and policy makers from both sides of the Atlantic.

We highlight three primary findings that emerge from the chapters. First, despite the concerns, transatlantic foreign policy rifts did not spill over into the economic realm or trigger economic backlash of any significance. Rather, the bulk of the evidence presented in this volume points to *the continuity in the transatlantic economic relationship and the resilience of the transatlantic economic marketplace in a period of political turmoil*. As Joseph Quinlan and Daniel Hamilton show in chapter 2, transatlantic trade and foreign direct investment have actually flourished in recent years, notwithstanding the bitter conflict over Iraq. As they conclude, "No other commercial artery in the world is as integrated and fused together by foreign investment, a fact lost on many pundits, parliamentarians and policy makers on both sides of the Atlantic."

Similarly, Bruce Stokes (in chapter 3) maintains that trade relations during the first term of the Bush administration did not substantially differ from the Clinton years. Trade disputes, from tax subsidies to the regulation of genetically modified foods, simply intensified, subsided, or replaced former ones. EU Trade Commissioner Pascal Lamy and US Trade Representative Robert Zoellick actually enjoyed a closer relationship than their predecessors. They defused a number of major trade disputes that they inherited. The United States and EU successfully resolved long-standing disputes over the EU's banana licensing regime and US corporate tax subsidies. In the tax dispute, the World Trade Organization (WTO) had authorized the EU to retaliate against the United States in the amount of \$4 billion per year in trade, an event that Zoellick characterized as a "nuclear" threat to the global trading system. As can be seen from Stokes' chapter, the content and timing of these disputes is largely explained by conventional domestic politics, and not by any geopolitical or administrative shift. In sum, the transatlantic economic relationship remains extremely strong, punctuated by periodic disputes in various sectors which implicate a relatively small percentage of overall transatlantic trade.

Second, the chapters present *dramatic differences in the degree of success (or failure) of transatlantic cooperation across regulatory areas*. In some areas, such as competition policy, US and EU regulators continue to hold broadly similar mandates and regulatory philosophies (chapter 4). The record of transatlantic cooperation in this area continues to be largely complementary, based on the sharing of information and resources. Occasional disagreements, such as the Commission's rejection of the GE/Honeywell merger, may be spotlighted in the media, but they are atypical (chapter 5). In other areas, however, such as the regulation of genetically modified organisms (GMOs), US and EU regulators operate with starkly different regulatory philosophies and styles in a highly politicized policy environment (chapter 8). The record of transatlantic regulatory cooperation in this sphere has been highly contentious, prompting the United States to file a legal complaint before the WTO. Regardless of the case's outcome, the management of this dispute will continue to try both sides.

In between the extremes of daily cooperation and polarized litigation, we find cases such as the transatlantic mutual recognition and data privacy protection agreements, in which the US and EU have found, to a certain extent, a *modus vivendi* between their different regulatory systems (chapters 6 and 7). In both cases, however, implementation has raised ongoing challenges. A notable change has occurred in financial services regulation, where both EU and US regulators have made impressive efforts to accommodate each other's regulatory systems by recognizing the adequacy of each other's standards in specific areas, as explored in chapter 9. Maria Green Cowles likewise shows how the functioning of the NTA's civil society dialogues has varied (chapter 10). While the transatlantic environment dialogue folded and the labour dialogue is inactive, the consumer and business dialogues continue. Nonetheless, even the flagship Transatlantic Business Dialogue struggled to attract the sustained attention of business leaders, reflecting the sporadic and uneven performance of the NTA in delivering business demands. Attempting to explain this sectoral variation in policy outcomes raises important questions for future research, for which our final point indicates one approach.

The volume's third finding is that *changes in institutional and market power have shaped policy outcomes in distinct regulatory areas*. Assessments of power have been relatively absent from previous studies of transatlantic economic relations. Previous studies have tended to emphasize the impact of economic globalization on the demand and supply of regulatory collaboration, and depicted the EU/US relationship as one of economic equals. Yet across the range of issues, the success of transatlantic cooperation, and the pattern of concessions by each side, has reflected varying power resources. These resources are not military ones, nor do they simply reflect market size, a traditional measure of economic clout. Although market size generally explains the growing role of the EU as a global actor in economic and regulatory fields, US and EU bargaining power also is affected by each side's *institutional* characteristics. In the case of financial services, for example, Posner maintains that it was not simply the size of the EU market, but also the establishment of the EU's regulatory competence and its extraterritorial reach which mattered. Institutional developments in the EU affected powerful US firms who, in turn, motivated the US Securities and Exchange Commission to work with EU authorities to accommodate and recognize EU standards in a number of areas. This development occurred following an extended period of benign (or malign) US neglect of European approaches to financial services regulation.

In keeping with Robert Putnam's (1988) discussion of two-level games, it appears that domestic institutions on both sides can influence bargaining outcomes by allocating "veto points" to domestic actors and thus allowing negotiators to claim that their hands are tied. This phenomenon is most apparent in the case studies of transatlantic mutual recognition agreements and the regulation of genetically modified foods. In the former case, Nicolaidis and Steffenson show that

Introduction

the European Union has complied with the terms of the existing MRAs, while the United States has largely reneged on three of these agreements after independent regulatory agencies (the FDA and OSHA) refused to recognize the equivalency of European certifiers. In contrast, the EU's institutional structure has provided multiple veto points to opponents of GM foods and crops which have undermined transatlantic attempts to reconcile US and EU regulatory approaches, resulting in deadlock.

Previous studies of transatlantic economic relations have tended to emphasize the joint gains from transatlantic cooperation, and we agree that significant gains are at stake. Yet the studies in this volume also show how power factors influence not only the overall potential for transatlantic cooperation on a sector-by-sector basis; they also influence the patterns of concessions and compromises offered by each side, and thus the distributional outcome for a sector.

The structure of the volume is as follows: In chapter 2, Joseph Quinlan and Daniel Hamilton examine transatlantic international trade and investment flows, noting how they have flourished in seeming oblivion to the political discord to date. Bruce Stokes assesses transatlantic trade negotiations and disputes in chapter 3, finding that the relationship between US and EU trade administrations has actually improved. In chapters 4 and 5, William Kovacic (Federal Trade Commission) and David Gerber respectively assess competition policy from institutional, pragmatic, and cognitive perspectives.

Turning to other regulatory areas, in chapter 6, Yves Pouillet and María Verónica Pérez Asinari examine the problems of implementing the US-EU data privacy "safe harbour" agreement. Kalypso Nicolaidis and Rebecca Steffenson analyze the analogous challenges confronting the various transatlantic mutual recognition agreements, in chapter 7. In chapter 8, Gregory Shaffer and Mark Pollack assess regulatory policy making for genetically modified organisms in the United States and Europe, noting how the US and EU have competed to advance their approaches in distinct bilateral and multilateral fora. Elliot Posner addresses the rising clout of the European Union as an actor in the field of financial services in chapter 9. Finally, in chapter 10, Maria-Green Cowles provides an update of the status and prospects for the various civil society dialogues established in the 1990s. In each case, these contributions are complemented by commentary from a leading academic or policy maker from the other side of the Atlantic, respectively Hugo Paemen (former EU ambassador to the United States and Co-chairman of the European-American Business Council), Ernst-Ulrich Petersmann (director of EUI's Transatlantic Programme), Stephen Wilks, Gregory Shaffer, Alasdair Young, Christian Joerges, and Nigel Wicks (former member of the EU Committee of Wise Men on the Regulation of European Securities Markets).

This volume arose out of a transatlantic collaboration between the University of Wisconsin's European Union Center (under its Transatlantic Initiative), the Robert

MARK A. POLLACK and GREGORY C. SHAFFER

Schuman Centre for Advanced Studies at the European University Institute (EUI) (under its Transatlantic Programme), and Johns Hopkins University's Center for Transatlantic Relations in Washington DC. We thank these institutions for their funding that made this transatlantic study and exchange possible. We also thank a number of others associated with the project, including our co-organizers David Andrews, Daniel Hamilton, and Joe Quinlan for their support; Helen Wallace for her extraordinarily engaged directorship of the Robert Schuman Centre; Laura Burgassi for her exceptional administrative assistance; and Rachel Epstein who took the reins of the Schuman Centre's Transatlantic Programme in September 2004 from David Andrews' able stewardship and saw this volume to fruition. Our most profound thanks, finally, go to the presenters and discussants at the transatlantic workshop at EUI in June 2004. Representing a mix of Europeans and Americans, academics and practitioners, they provide us with empirical updates of the status of the transatlantic economic relationship at the beginning of 2005 and introduce us to new ways of thinking about the ongoing promise and considerable challenges posed.

Chapter 2

Partners in Prosperity: The Changing Geography of the Transatlantic Economy

*Daniel S. Hamilton
Joseph P. Quinlan*

I. Executive summary

- One of the defining features of the global economic landscape over the past decade has been the increasing integration and cohesion of the transatlantic economy. Globalization is happening faster and reaching deeper between Europe and America than between any other two continents.
- European and American economies and societies have not drifted apart since the end of the Cold War; they have become even more intertwined and interdependent.
- Despite the perennial hype about the significance of Nafta, the “rise of Asia” or “big emerging markets,” the United States and Europe remain by far each other’s most important commercial partners. The economic relationship between the United States and Europe is by a wide margin the deepest and broadest between any two continents in history—and those ties are accelerating.
- The years since the Cold War—the years when the fading “glue” of the Cold War partnership supposedly loosened transatlantic ties—marked in fact one of the most intense periods of transatlantic integration ever.

- The transatlantic economy generates roughly \$2.5 trillion in total commercial sales a year and employs over 12 million workers in mutually “insourced” jobs on both sides of the Atlantic who enjoy high wages, high labour and environmental standards, and open, largely non-discriminatory access to each other’s markets.

A. *It’s Foreign Investment, Stupid*

- Transatlantic trade squabbles steal the headlines but account for only 1-2 % of transatlantic commerce. In fact, trade itself accounts for less than 20% of transatlantic commerce.
- Trade flows are a misleading benchmark of transatlantic economic interaction. Foreign investment, not trade, drives transatlantic commerce, and contrary to common wisdom, most US and European investments flow to each other, rather than to lower-wage developing nations.
- Foreign affiliate sales, not trade, are the backbone of the transatlantic economy. In 2001 foreign affiliate sales amounted to \$2.8 trillion, more than five times the \$549 billion in total trade. Despite tensions over Iraq, foreign affiliate sales were up in 2003 and then again in 2004.
- When one adds investment and trade together to get a more complete picture, one sees that US economic engagement remains overwhelmingly focused on Europe. The transatlantic economy is where the markets are, where the jobs are, where the profits are.
- Foreign affiliate sales not only dwarf transatlantic trade flows but also every other international commercial artery linking the United States to the rest of the world. In 2001, total foreign affiliate sales between the U. S. and Europe were more than double US-transpacific foreign affiliates sales, more than three times larger than total transpacific trade flows, and more than four times larger than foreign affiliate sales between the US and Nafta partners Mexico and Canada.
- Despite transatlantic tensions over Iraq, US firms ploughed a near-record \$100 billion into Europe in 2003. In 2004, US investment to Europe soared by another 50% in the first of 2004 to \$60 billion, setting it on pace to reach a record high of \$120 billion.
- Europe accounted for nearly 65% of total US foreign direct investment in 2003.
- Even though US-German relations ebbed to one of their lowest levels since World War II, American firms sank \$7 billion in Germany in 2003, a sharp reversal from 2002, when US firms pulled some \$5 billion out of Germany.

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- Despite Franco-American diplomatic tensions, US investment flows to France in 2003 rose by more than 10% to \$2.3 billion, and US affiliates more than doubled their profits in France to \$4.3 billion. French firms were also among the largest European investors and largest foreign sources of jobs in the US—Corporate France invested \$4.2 billion in the United States in 2003.
- US investment in Ireland alone in 2003 (\$4.7 billion) was more than two-and-a-half times greater than US investment in China (\$1.7 billion).
- US investment flows to Denmark between 2000 and 2003 (\$4.1 billion) were nearly three times greater than US flows to India (\$1.5 billion).
- The \$19.2 billion of US investment in the Netherlands alone in 2003 was not far behind total US investment in all of Asia (\$22.4 billion).
- Europe's investment stakes in the US, on a historical-cost basis, exceeded \$1 trillion in 2002, 20% more than America's stake in Europe. Europe's investment stake in the US doubled between 1998 and 2002. Europe accounts for nearly three-fourths of all foreign investment in the US. No other region of the world has made such a large capital commitment to the United States. European firms have never been as exposed to the US economy as they are today.
- Virulent anti-war sentiment across Europe did not prevent European firms from investing \$36.9 billion in foreign direct investment in the US in 2003. That represents a sharp rebound from the depressed levels of 2002, when European FDI inflows to the United States totalled \$26 billion.

B. *Europe and America: That's Where the Profits Are...*

- Europe is the most important commercial market in the world for corporate America by a wide yet underappreciated margin. US companies continue to rely on Europe for half their total annual foreign profits.
- Similarly, the United States is the most important market in the world in terms of earnings for many European multinationals. The annual earnings of Europe's US affiliates has risen tenfold since the end of the Cold War, from \$4.4 billion in 1990 to \$ 44 billion in 2003 and \$60 billion in 2004.
- Despite talk of transatlantic boycotts or consumer backlash due to European- American tensions over Iraq, 2003 was a banner year for transatlantic profits as measured by foreign affiliate income.
- US foreign affiliate earnings from Europe surged to a record \$ 82 billion in 2003, a 25% jump from 2002.
- US affiliate earnings in 12 European markets (France, the Netherlands, Switzerland, Italy, Ireland, Spain, Belgium, Denmark, Sweden, Austria, Czech Republic and Poland) reached record highs in 2003. US affiliate

profits in France more than doubled. Profits earned in Ireland surged by 45%, in Italy by 40%, and in the Netherlands by 24.5%.

- 2003 was also a record year for profits of European affiliates operating in the United States. Despite the strong euro, European affiliate earnings of \$ 44 billion easily surpassed earnings of 2002 (\$32.23 billion) and 2001 (\$17.4 billion), and the previous peak in earnings of \$38.8 billion in 2000.
- British, Dutch, Swiss and Swedish foreign affiliates all enjoyed record US profits in 2003.

C. *That's Where the Markets Are...*

- Corporate America's foreign assets tallied over \$5.8 trillion in 2001. The bulk of these assets—roughly 60%—were located in Europe.
- Most of the top destinations for US investment in the world in 2002 were European: the UK (1), the Netherlands (3), Switzerland (4), Germany (6), Belgium/Luxembourg (8) and France (10).
- Transpacific linkages based on trade are relatively shallow in comparison to the deeper transatlantic linkages rooted in foreign direct investment.
- The United Kingdom is the most important market in the world for corporate America. US assets in the United Kingdom—roughly \$1.4 trillion in 2001—were more than 50% larger than the entire US asset base in Asia and almost equivalent to the combined overseas affiliate asset base of Asia, Latin America, Africa and the Middle East.
- The UK, not China or Mexico, was at the forefront of America's great overseas investment boom of the 1990s, attracting just over 20% of total US FDI over the period. The Netherlands was second.
- Despite all the talk about Nafta and the "Pacific Century," over the past decade US firms have ploughed ten times as much capital into the Netherlands as into China, and twice as much into the Netherlands as into Mexico.
- US assets in Germany in 2001 of \$320 billion were greater than total US assets in all of South America.
- In 2001, US affiliates accounted for 16% of Ireland's total output, 7.2% of the UK's aggregate output, and 6.2% of the Netherlands.
- Europe accounted for roughly 55% of the total gross global product of US affiliates in 2001—\$583 billion.
- European firms held some \$3.7 trillion in US assets in 2001, nearly 70% of the total.
- US foreign affiliates in Europe achieved sales of \$1.5 trillion in 2001—5½ times the \$276 million in US exports to Europe.

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- Europe accounted for just over 51% of global US foreign affiliate sales in 2001.
- US affiliate sales in Europe were more than double affiliate sales in the entire Asia/Pacific region in 2001. US affiliate sales in the UK alone (\$428 billion) exceeded aggregate sales in Latin America.
- Even though US affiliate sales in China have soared, they have done so from a very low base. Sales of \$36 billion in China in 2001, for example, were on par with those in Sweden (\$33 billion) and well below sales in either Germany (\$240 billion) or France (\$135 billion).
- Weak European growth means lost opportunities for Americans. Growth of just 3% in Europe would create a new market the size of the entire country of Argentina for companies and investors from the US and other countries.
- Affiliate sales, not trade, also represent the primary means by which European firms deliver goods and services to US consumers. In 2001 European affiliate sales in the US (\$1.4 billion) were over four times larger than European exports to the US
- UK affiliate sales in the US in 2001 were more than five times the amount of UK exports to the US German affiliate sales in the US were more than four times greater than German exports to the US—a striking statistic for Germany, a country commonly thought to be a classic “trading” nation.
- Contrary to most assessments of transatlantic drift since the end of the Cold War, Europe’s investment stake in the US has deepened dramatically since the fall of the Berlin Wall: Income of European affiliates in the US rose ten-fold between 1990 and 2003—from \$4.4 billion to \$ 44 billion.

D. *That’s Where the Jobs Are...*

- The bulk of corporate America’s overseas workforce is employed in Europe, not in low-wage countries like Mexico, China or India. Of the nearly 9.8 million workers employed by US foreign affiliates in 2001, roughly 43% work in Europe.
- The US also “insources” more jobs from Europe than it “outsources” across the Atlantic. In fact, the US enjoys a “million worker surplus” with Europe. In 2001 European affiliates of US firms directly employed roughly 3.2 million workers, while US affiliates of European firms directly employed just over 4.2 million US workers.
- The US insourced more jobs from Belgium, France, Germany, the Netherlands and Switzerland than it outsourced in 2001. US firms employed slightly more workers in the United Kingdom than British firms in the United States.

- The transatlantic workforce directly deployed by US and European foreign affiliates is massive, totalling over 8.4 million workers in 2001. That is three times the number of total workers employed by US affiliates in Nafta partners Canada and Mexico (2.8 million). It is also well above total foreign employment of US foreign affiliates in Asia and Asian foreign affiliates in the United States (2.3 million).
- Europe is by far the greatest source of America's insourced jobs. European firms employed roughly two-thirds of the 6.4 million US workers on the payrolls of foreign affiliates in 2001. The top five employers in the US are the United Kingdom (1.1 million), Germany (734,000), France (578,000), the Netherlands (571,000) and Switzerland (546,000).
- Figures tracking direct employment due to investment alone do not include indirect employment related to non-equity arrangements like strategic alliances, joint ventures and other deals. Moreover, affiliate employment figures do not include jobs supported by trade with Europe. Employment related trade is substantial in many US states and European regions. In total, and adding in indirect employment, we estimate that the overall transatlantic work force numbers some 12-14 million workers.

E. That's Where Trade Opportunities Still Lie...

- 2003 was a record year for transatlantic trade flows. Total transatlantic trade in goods grew by 7% to \$391 billion in 2003. In 2004, it was projected to increase again to \$475 billion.
- US exports, supported by the weaker US dollar, recovered from the two-year downturn in trade with Europe and grew by 4.8% to \$150.6 billion in 2003.
- US imports from Europe jumped 8.5% to a record \$245 billion in 2003 —despite a 20% appreciation of the euro against the dollar. America's trade deficit with the EU widened by 15% to a record \$94.3 billion in 2003. Surging imports from Europe produced record US trade deficits with Germany, Italy, Ireland, France and the Netherlands.
- Surging US demand for European products in 2003 offset the dampening trade impact of weak European economic growth and a surging euro. Roughly 57% of total US imports from Europe is considered related party trade, which means more than half of US imports from Europe are affected less by exchange rates than by US demand. 67% of US imports from Germany, 59% of US imports from the Netherlands and 54% of US imports from the United Kingdom are considered related party trade.
- The US current account deficit with Europe in 2003 reached an estimated \$94 billion, up 9% from 2002.

F. *That's Where Opportunities Are for States and Regions...*

- The commercial relationship between the United States and some regions of Europe, such as Baden-Württemberg, Ile-de-France, or South East England, is greater than that between the United States and most countries in the world.
- Three German states—Hesse, Baden-Württemberg, and North Rhine-Westphalia—invested more in the United States in 2001 than they did in the entire European Union outside of Germany.
- Despite much talk of big emerging markets, three German states—Bavaria, Baden-Württemberg and North-Rhine Westphalia—have a higher GDP than the four Asian tigers—South Korea, Taiwan, Singapore and Hong Kong.
- The Pacific coast state of California is Europe's main commercial partner in the United States and is the sixth-largest economy in the world, just behind France and Britain.
- California alone exported some \$20.4 billion in goods to Europe in 2003, an amount greater than total US exports to OPEC.
- Texas ranked as the top US state for European investment in general and for French investment in particular in 2001. Europe's investment stake in Texas topped \$68 billion in 2001. There is more European investment in Texas alone as all US investment in Japan and China put together.
- European companies are the top foreign investor in 45 states, and ranked second in the remaining five states in 2001.
- The Southeast of the United States accounted for nearly 23% of total European investment in 2001 and ranks as the top US region for British, French, Dutch, Swedish and Belgian investments. No other region of the US benefits more from European investment.
- The Great Lakes region ranks second to the Southeast in overall investment attractiveness to Europe, and is the favoured destination of German firms.
- The United Kingdom ranked as the number one European export market for 25 states in 2003. Germany was a distant second, ranking as the top European export market for 10 US states in 2003.

G. *That's Where Services Are...*

- The service economies of the United States and Europe have never been as intertwined as they are today, notably in such activities as financial services, telecommunications, utilities, insurance, advertising, computer services and other related functions.
- Foreign affiliate sales of services on both sides of the Atlantic have exploded over the past decade. In fact, affiliate sales of services have not only become a viable second channel of delivery for US and European

multinationals, they have become the overwhelming mode of delivery in a rather short period of time. Nothing better illustrates the ever-deepening integration of the transatlantic service economy.

- Sales of services by US foreign affiliates in Europe soared from \$85 billion in 1994 to roughly \$234 billion in 2001—a 175% increase, well ahead of the 64% rise in US service exports to Europe over the same period.
- US foreign affiliate sales of services in Europe—after being roughly equal to US service exports to Europe in 1992—were more than double the value of US service exports in 2001.
- Europe leads the way in terms of US foreign affiliate sales of services, just as it does in global US affiliate sales of goods. In 2001, Europe accounted for 54% of total US affiliate sales (\$432 billion), with Asia (a 20% share) and Latin America (13%), a distant second and third, respectively.
- Foreign affiliate service sales of \$124 billion in the UK alone in 2001 were greater than foreign affiliate service sales in all of Asia (\$87 billion) and Latin America (\$54 billion).
- Sales of services by US affiliates of European firms have also soared over the past decade. As Europe's investment position in services has expanded in the US, so have Europe's foreign affiliate sales of services. The latter totalled \$249 billion in 2001 versus \$86 billion in 1994, a jump of 190%, well ahead of the 83% rise in European service exports to the US over the same period.

H. That's Where the Research Is...

- 60% of US corporate research and development conducted outside the United States is conducted in Europe. R&D expenditures by US foreign affiliates are greatest in the UK, Germany and France, in that order.
- European R&D expenditures in the US are substantial and dwarf expenditures spent by Asian counterparts, namely Japan.

I. That's Where the Money Is...

- Europe is not only a critical source of revenue for blue-chip companies, it is also a key supplier of capital or liquidity for the debt-stretched United States, which presently must borrow over \$1.4 billion a day to finance its current account deficit.
- European investors purchased a record \$169 billion in US corporate bonds in 2003—52% more than in 2002.

J. *That's Who Is Connected in a Globalizing World...*

- Interregional internet bandwidth underscores the “thick” nature of transatlantic connectivity. Between 2001 and 2003 transatlantic internet bandwidth doubled, to more than three times that of North American connections to Asia and the Pacific, 7½ times that between North America, Latin America and the Caribbean, and 87 times that of European connections to Asia and the Pacific.

K. *Drifting Apart? Or Growing Together?*

- In sum, the years since the fall of the Berlin Wall have witnessed the greatest period of transatlantic economic integration in history. Our mutual stake in each other's prosperity and success has grown dramatically since the end of the Cold War. Ignoring these realities is short-sighted and short-changes American and European consumers, producers, investors, workers and their families.

**II. Mars, Venus—or Mercury?
Commerce Trumps Diplomacy in a Year of War**

These days, political pundits are fond of quoting Robert Kagan's quip that Americans are from Mars and Europeans are from Venus. Those images were reinforced by transatlantic disputes over Iraq in 2003. But the related tale of 2003 is that both Mars and Venus should take greater heed of Mercury, the god of commerce.

For transatlantic relations, 2003 was a year of political bust and economic boom. Even as transatlantic bickering engendered by America's war with Iraq plunged transatlantic political relations to one of its lowest points in six decades, the economic ties that bind the United States and Europe together only grew stronger in 2003.

2003 was a banner year for the transatlantic economy (see Table 1). Transatlantic trade, foreign direct investment, portfolio flows and profits all rebounded robustly from the cyclical economic downturn of 2001-02. Economic integration strengthened in a year of political disintegration. What is perhaps most striking is that during the first six months of the year—the months of greatest transatlantic political tension—economic engagement deepened considerably between the United States and those two bad “old” boys of Europe, France and Germany.¹

1 US Defence Secretary Donald Rumsfeld described France and Germany as part of “old Europe” and countries such as Spain, Britain, Poland and other central European nations as part of “new Europe” when asked why some European countries were supporting the US effort against Iraq while others were opposed.

2003: A Record-Setting Year for the Transatlantic Economy

The following all-time highs were recorded in 2003:

Transatlantic Investment

European net purchases of US corporate bonds: \$169 billion

Transatlantic Trade

Total transatlantic trade in goods: \$395 billion

US trade deficit with European Union: \$94.3 billion

US current account deficit with the European Union: \$94 billion

US imports from the European Union: \$244.8 billion

US imports from Germany: \$68.1 billion

US trade deficit with Germany: \$39.2 billion

US imports from Italy: \$25.4 billion

US trade deficit with Italy: \$14.9 billion

US imports from Ireland: \$18.1 billion

US trade deficit with Ireland: \$25.8 billion

US imports from Spain: \$6.7 billion

US trade deficit with France: \$12.2 billion

US trade deficit with the Netherlands: \$9.7 billion

Transatlantic Profits (affiliate income)

US profits in Europe: \$82 billion

US profits in the Netherlands: \$17.9 billion

US profits in Switzerland: \$10.7 billion

US profits in Ireland: \$6.8 billion

US profits in France: \$4.3 billion

US profits in Italy: \$3.1 billion

US profits in Spain: \$2.5 billion

US profits in Belgium: \$2.0 billion

US profits in Denmark: \$1.4 billion

US profits in Sweden: \$1.2 billion

US profits in Austria: \$578 million

US profits in Poland: \$466 million

US profits in Czech Republic: \$182 million

European profits in the US: \$46.4 billion

UK profits in the US: \$16.5 billion

Netherlands profits in the US: \$8.9 billion

Switzerland profits in the US: \$6.4 billion

Sweden profits in the US: \$2.1 billion

Source: US Department of Commerce

Despite Washington's war-related frustrations with Europe, corporate America pumped over \$100 billion in foreign direct investment (FDI) into Europe in 2003. That represents a jump of more than a third over 2002 and was more than double the rate of growth of total US investment outflows for the year. As is customary, US investment flows to the United Kingdom dominated total EU investment, with US firms sinking nearly \$25.4 billion in the UK in 2003, roughly 30% of the EU total. Yet even after adjusting for massive flows to United Kingdom, US foreign investment to Europe approached \$62 billion in 2003, a staggering rise of 29% from a year earlier.

Germany was one favoured destination of US firms in 2003, notwithstanding the fact that US-German relations ebbed to one of the lowest levels since World War II. American firms sank \$7 billion in Germany in 2003, a sharp reversal from the corresponding period in 2002, when US firms pulled some \$5 billion out of Germany. One of the largest deals involved Procter & Gamble's \$5.7 billion acquisition of Wella.

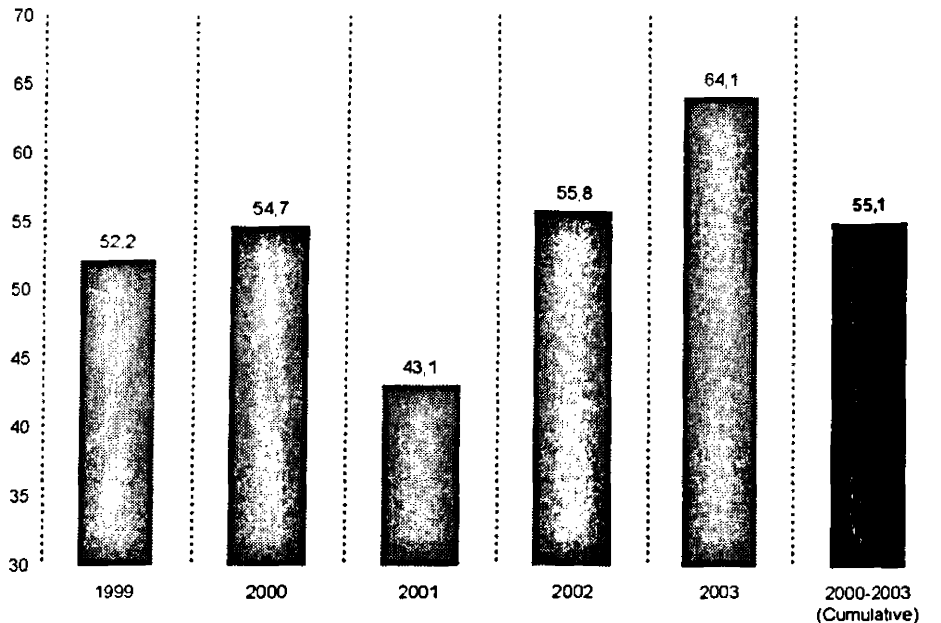
Transatlantic commerce with other European countries flourished. US investment in Ireland (\$4.7 billion) was more than two-and-a-half times greater than US investment to China (\$1.7 billion). The \$19.2 billion of US investment in the Netherlands was not far behind total US investment in all of Asia (\$22.4 billion). And despite intense diplomatic tensions between the US and France in 2003, US investment flows to France rose by more than 10% to \$2.3 billion.

In short, while the US House of Representatives spent its time changing French fries to "freedom fries," US firms in France and other parts of Europe were busy seeking out strategic acquisitions, further deepening transatlantic ties. In a year when US-European political relations had seldom been rockier, American firms remained confident and committed to Europe, with the region alone accounting for nearly 65% of total US foreign direct investment in 2003.

Meanwhile, virulent anti-war sentiment across Europe did not prevent European firms from investing \$36.9 billion in foreign direct investment in the US in 2003. That represented a sharp rebound from the depressed levels of the prior year, when European FDI inflows to the United States totalled \$26 billion. As is usually the case, British firms lead the investment foray into the US, yet even after excluding the UK, European investment flows to the US totalled just over \$10 billion in 2003, roughly on par with aggregate inflows in 2002. Ironically, French firms were among the largest European investors in the US in 2003, with Corporate France sinking some \$4.2 billion in the United States. German foreign investment in the US declined again in 2003 (with disinvestments of \$1.2 billion), although the contraction in investment was a fraction of the decline experienced in 2002 (\$4.6 billion).

Corporate America's Bias Towards Europe

US foreign direct investment (FDI) outflows to Europe as % of total



Source: Bureau of Economic Analysis

In addition to the nearly \$37 billion in foreign direct investment the US received from Europe in 2003, Euroland investors (excluding the United Kingdom) ploughed another \$50 billion into US dollar-denominated assets like US Treasuries, government agency bonds, corporate bonds and US equities. European investors (including UK flows) were particularly enamoured with US corporate bonds, purchasing a record \$169 billion in corporate bonds in 2003—52% above the levels of the prior year. The UK accounted for the bulk of purchases of corporate bonds (\$108 billion), but net corporate purchases from Euroland still totalled a record \$29 billion in 2003, a rise of 82% from the previous year.

On a country basis, German portfolio managers snapped up nearly \$10 billion in total US securities in 2003, following net purchases of just \$1.1 billion in 2002. French investors bought \$4 billion in US securities in 2003, down from \$5.6 billion the prior year. Total net purchases from the United Kingdom totalled a staggering \$164.4 billion in 2003. However, net buying from London, reflecting the city's role as a global financial hub, includes net purchasing from the Middle East, eastern Europe and other geographic areas.

All totalled, transatlantic capital flows—both foreign direct investment and portfolio flows—rose dramatically in 2003. Whenever and wherever strategic

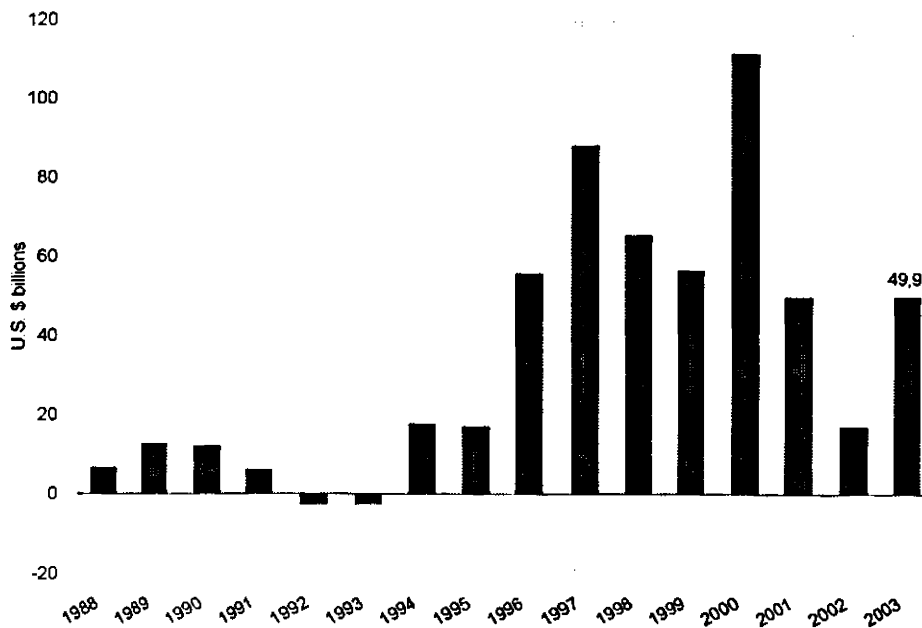
Partners in Prosperity: The Changing Geography of the Transatlantic Economy

opportunities presented themselves, US firms were unhesitant about acquiring European firms. General Electric, Procter & Gamble, United Technologies—a fairly representative body of Corporate America—all made European acquisitions in excess of \$1 billion in 2003. In the United States, European firms like Henkel, Axa and Deutsche Post did the same, building out their strategic US presence amid all the threats of a transatlantic alliance in crisis. European portfolio managers, meanwhile, were busy adding high-grade US corporate bonds to their portfolios.

2003 was also a record year for transatlantic trade flows. Total transatlantic trade in goods rose to \$391 billion in 2003. US imports from Europe hit a record \$245 billion in 2003—despite the massive appreciation of the euro against the dollar. America's goods deficit with the EU widened to a record \$97 billion in 2003. Meanwhile, the US current account deficit with Europe reached a record \$94 billion, up 9% from the prior year.

The rise in the euro against the dollar has spawned a great deal of angst across Europe. However, the strong euro/weak dollar did not have much effect on US imports from Europe in 2003. In fact, US imports from Germany, Italy, Ireland, and Spain all reached record levels in 2003, with strong US demand offsetting the

Euroland Net Purchases of US Securities



Excludes purchases from the United Kingdom

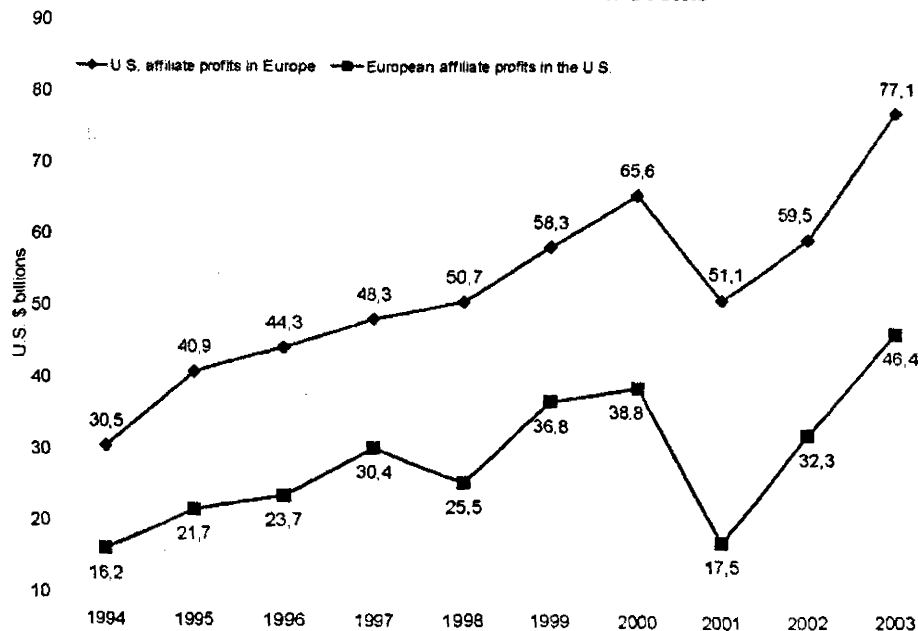
Source: US Treasury Department

negative effect from the strong euro. Not surprisingly, surging imports from Europe produced record US trade deficits with Germany, Italy, Ireland, France and the Netherlands.

Finally, despite all the talk of a transatlantic boycott or a consumer backlash on both sides of the ocean, 2003 was a banner year for transatlantic profits as measured by foreign affiliate income. US foreign affiliates in Europe reaped a profits windfall from the declining US dollar against the euro, with the dollar sliding over 40% against the euro from the end of 2001 to the end of 2003. The effect was to greatly inflate the dollar-based earnings of US affiliates in Europe. Indeed, US foreign affiliate income from Europe surged to a record \$ 82 billion last year, more than a 30% jump from the prior year. Over the same period, US affiliate profits in France more than doubled, to \$4.3 billion, while profits earned in Ireland surged by 45%, in Italy by 40%, and in the Netherlands by 24.5%.

In all, US affiliate earnings in some twelve European markets (France, the Netherlands, Switzerland, Italy, Ireland, Spain, Belgium, Denmark, Sweden, Austria, Czech Republic and Poland) reached record highs in 2003. This broadly-based profits bonanza helped boost total US pre-tax corporate profits by 18% last year, one of the strongest annual rises in decades.

A Banner Year for Transatlantic Profits*



* Income of affiliates

Source: Bureau of Economic Analysis

2003 was also a record year for profits of European affiliates operating in the United States. Notwithstanding the strength of the euro against the US dollar—a significant headwind to earnings—European affiliate earnings of \$44 billion in 2003 easily surpassed earnings of 2002 (\$32.23 billion) and 2001 (\$17.4 billion), and the previous peak in earnings of \$38.8 billion in 2000. The earnings boost was driven by robust US demand, which greatly offset the negative effect of the appreciation of the euro and the British pound, as well as weak European growth again in 2003. British, Dutch, Swiss and Swedish foreign affiliates all enjoyed record US profits in 2003.

At first glance, the news is good: transatlantic commerce, fuelled by mutual investment, remains robust and seems more attuned to good economics than bad diplomacy. But the underlying reality is that the relationship between the transatlantic strategic and economic agendas has reversed. During the Cold War, leaders strove to keep transatlantic economic conflicts from spilling over to the core political alliance. Now the challenge is to keep transatlantic political disputes from damaging the core economic relationship.

Pouring French wine down the drain or vandalizing McDonald's may make for splashy headlines, but the more significant development is the accelerating integration of the European and US economies. Transatlantic divorce? We literally cannot afford it.

Case Study

Why Exchange Rates Matter Less Than We Think: The Story of Related Party Trade

How Related Party Trade Influences Transatlantic Trade Flows

Transatlantic trade rebounded in 2003 following a two-year slump, which saw total trade between the US and European Union fall 4% between 2000 and 2002. In 2003, total transatlantic trade in goods rose to \$396 billion, a 7% increase from the prior period.

Not unexpectedly, US exports, supported by the weaker US dollar, recovered from the two-year downturn in trade with Europe, rising to \$150.6 billion in 2003. That represented a healthy 4.8% annual increase—yet US export growth pales in comparison to US import growth from Europe in 2003. In fact, US imports from Europe jumped 8.5% in 2003, rising to a record \$245 billion in a year when the Euro appreciated by 20% against the dollar between year-end 2002 and year-end 2003.

Following such a large shift in prices or exchange rates, Economics 101 would have predicted a rebalancing of bilateral trade. Theory would have expected US export growth to outstrip US import growth, leading to an improvement in the overall trade balance. In fact, the opposite occurred: America's trade deficit with

Europe actually widened by nearly 15% in 2003, with the deficit jumping to a record \$94.3 billion.

Seemingly impervious to the strength of the euro, US imports from Germany rose by nearly 9% in 2003. US exports to Germany actually declined, dropping by over 11%, leaving a record trade deficit of \$35.9 billion with Europe's largest economy. Elsewhere, US imports from the Netherlands rose by 11.2% in 2003, while imports from Spain jumped by nearly 10%. US imports from France did fall in 2003, by 6.6%, but so did US exports to France, leaving a record US trade deficit of just over \$12.2 billion.

The fact that transatlantic trade flows have yet to adjust to the massive revaluation of the euro against the US dollar have confounded many on both sides of the Atlantic. Two years after the euro's stunning rise against the dollar, America's trade deficit with Europe should have begun to narrow, with US exports growing at a faster pace than imports. That is conventional wisdom, which has not panned out.

Missing from the debate over trade and missing from conventional analysis is this: an unusually large percentage of US imports from Europe are considered related party trade, or trade that takes place between a parent cooperation, such as Siemens of Germany, and its foreign affiliate in the United States.

Parent-affiliate trade is less responsive to shifts in prices or exchange rates and more attuned to domestic demand. Accordingly, while a strong euro, in theory at least, would be associated with a decline in European competitiveness in the United States, the fact that many European multinationals produce, market and distribute goods on both sides of the ocean gives firms a high degree of immunity to a dramatic shift in exchange rates. Roughly 57% of total US imports from Europe are considered related party trade, which means more than half of US imports from Europe are not affected by exchange rates in the traditional sense. That is well above the global average for the US, with some 48% of all US imports considered related party trade.

Related Party Trade 2002

	US Imports: Related Party Trade, <u>as % of Total</u>	US Exports: Related Party Trade, <u>as % of Total</u>
European Union	56,8	31,0
France	42,6	27,9
Germany	67,2	33,6
Netherlands	58,9	42,6
United Kingdom	53,3	28,1
Other European Union	55,1	28,1

Under this structure, trade flows are driven more by demand in the host nation. As such, when the US economy exhibits strong growth, as in 2003, European affiliates in the United States produce and sell more products, which in turn, generates more demand (a.k.a imports) from the parent company for parts and components irrespective of exchange rate movements.

Related party trade can have a significant impact on bilateral trade between individual nations. Only after recognizing that roughly two-thirds of US imports from Germany are considered related party trade, for example, can one begin to understand and explain why US imports from Germany remained so strong in a year when the dollar plummeted against the euro (US imports from Germany rose 8.8% in 2003 from the prior year). Roughly 59% of US imports from the Netherlands are considered related party trade; around 54% of US imports from the United Kingdom are classified as related party trade as well.

Around one-third of US exports to Europe are classified as related party trade, lower than US imports from Europe. This, in part, reflects the fact that US affiliates in Europe source more goods from local sources, thus reducing trade, than European affiliates in the United States.

III. The Ties That Bind: Quantifying the Primacy of the Transatlantic Economy

Many feared the United States and Europe were drifting apart in 2003 and that a seismic geopolitical shift was in the making. The reality, however, is that while the "Iraq" effect did place a great deal of stress on one of the world's most important bilateral relationships, one reason why the transatlantic alliance held together in 2003 is that it is firmly anchored by deep and far-reaching commercial ties.

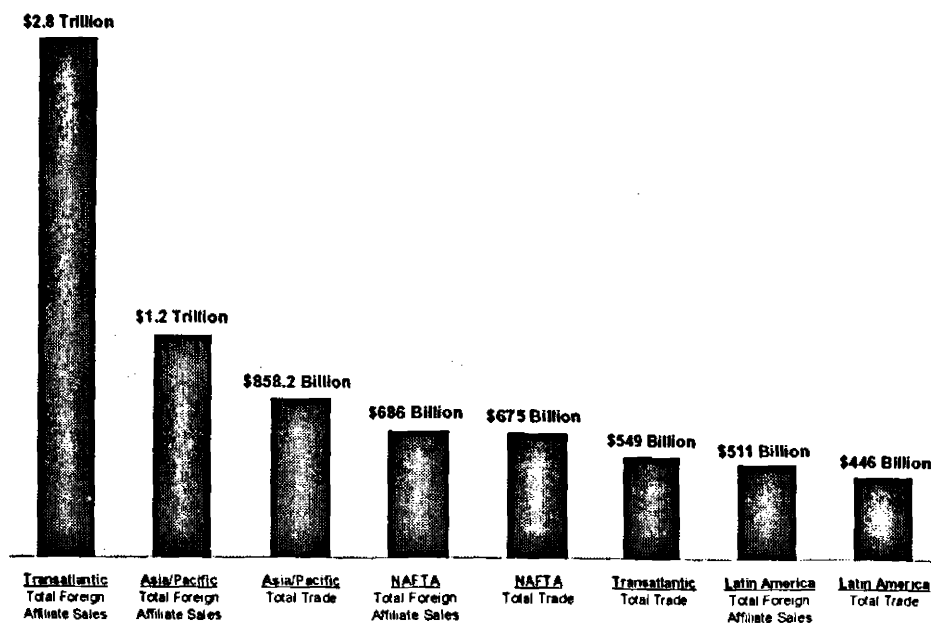
Loose talk about an alliance without common bonds, or a partnership devoid of relevance, ignores the simple yet powerful fact that transatlantic commercial ties are the largest and deepest in the world—bar none. The transatlantic economy is bound together by foreign direct investment (a deep form of integration) as opposed to trade (a shallow form of integration). Foreign affiliate sales, not exports, are the primary means by which US firms deliver goods and services to customers in Europe. The same holds true for European firms delivering products in the United States—trade flows are secondary to foreign affiliate sales. This has been the transatlantic norm for decades, not years. While exports and imports are the most common measures used in the media or by political pundits to evaluate cross-border activity between two parties, foreign direct investment and the activities of foreign affiliates are the backbone of transatlantic commercial activity.

Lost in the transatlantic debate is the fact that the US and European companies invest more in each other's economies than they do in the entire rest of the world. Transatlantic commercial ties are the largest in the world, with total commerce

amounting to roughly \$2.5 trillion in 2001. That figure includes total two-way trade between the US and Europe, plus total foreign affiliate sales, adjusted for potential double counting of affiliate sales and exports/imports. This relationship employs directly or indirectly over 12 million people on both sides of the Atlantic who enjoy higher wages, higher labour and environmental standards, and open, largely non-discriminatory access to each other's markets.

Despite rhetorical flourishes one hears about shifting American priorities due to Nafta or the "Asian Century," over the past decade American investment in the Netherlands alone was more than twice what it was in Mexico and nearly ten times what it was in China. Europe, not Asia or Latin America, is the most important source of global earnings for American companies. Similarly, for many leading European firms, the United States remains the most important market in the world.

America's Major Commercial Arteries



Foreign affiliate sales: data for 2001

Total trade: data in goods & services for 2002

Source: US Department of Commerce

Total transatlantic sales of foreign affiliates topped \$2.8 billion in 2001, the last year of available data. That is some five times greater than total transatlantic trade

of goods and services. Foreign affiliate sales not only dwarf transatlantic trade flows but also every other cross-border commercial artery linking the United States with the rest of the world. For instance, total foreign affiliate sales between the United States and Europe were more than double the comparable figures for total US-transpacific foreign affiliates sales in 2001 and more than three times larger than total transpacific trade flows. They were also four times larger than foreign affiliate sales between the United States and its North American Free Trade Agreement (Nafta) partners, Mexico and Canada.

A. Seven Key Indices of Transatlantic Commercial Activity

The primacy of foreign affiliate sales in driving transatlantic commerce reflects the underlying commercial infrastructure that links the United States with Europe. This infrastructure has been in the making for over a century, yet remains largely invisible to policy makers on both sides of the Atlantic. After examining the following seven variables, however, a clearer picture of the transatlantic economy emerges.

1. Gross Product of Foreign Affiliates

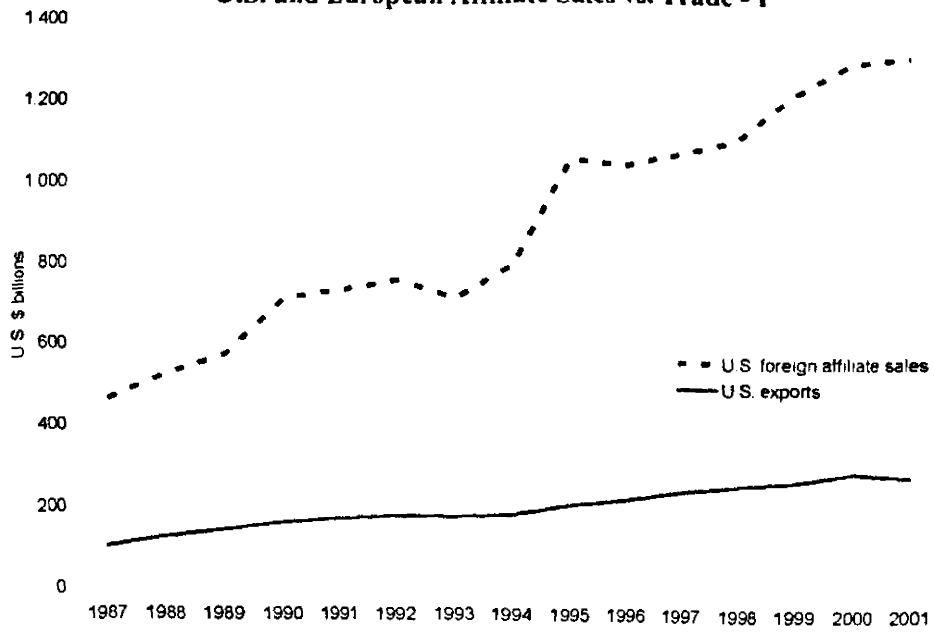
In various European countries, the presence of US affiliates remains striking. In Ireland, for instance, US affiliates accounted for 16% of the nation's total output in 2001. US affiliates accounted for 7.2% of the UK's aggregate output in the same year and 6.2% of the Netherlands. In the United States, the total output of British affiliate topped \$100 billion in 2001; the economic output of German, Dutch and French foreign affiliates totalled \$50 billion, \$44 billion and \$40 billion, respectively.²

The 2001-2002 cyclical recession dampened transatlantic affiliate output. Total output of US foreign affiliates in Europe and of European affiliates in the United States declined in 2001 on account of weak economic growth on both sides of the Atlantic. Output of US foreign affiliates in Europe dropped 3% in 2001 from the prior year, yet still totalled some \$318 billion for the year. European affiliates in the United States produced some \$308 billion in output in 2001, down sharply from the \$345 billion in total output in 2000. Since the US economy was the weakest link of the transatlantic economy in 2001, with the US experiencing a three-quarter economic recession, European affiliates in the US bore the largest brunt of the transatlantic downturn of 2001. However, with foreign affiliate output on both sides

2 An affiliate is defined as a business enterprise whereby a US or foreign firm owns or controls 10% or more of the voting securities of the incorporated firm. Gross product of affiliates is for majority-owned affiliates.

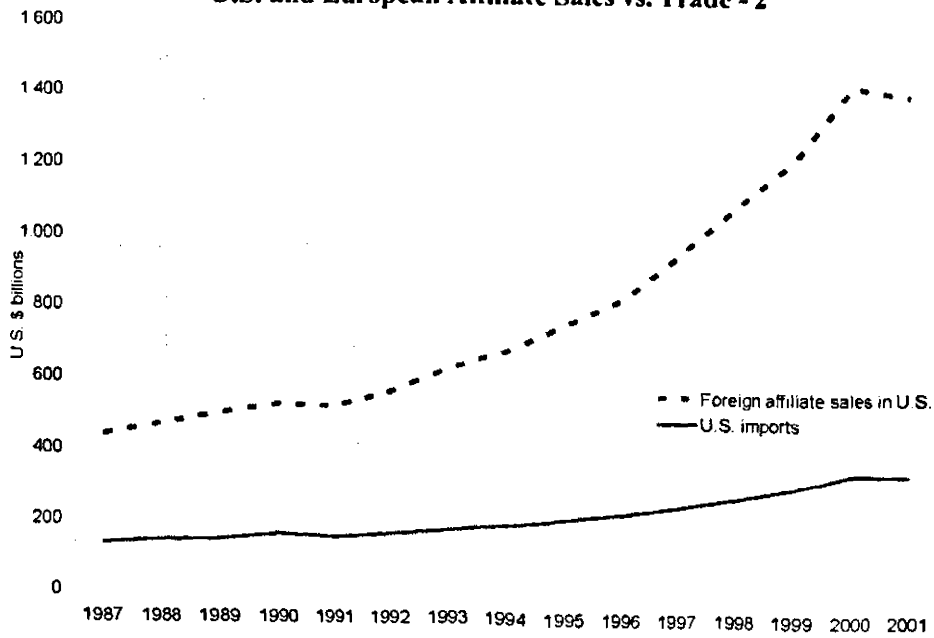
DANIEL S. HAMILTON and JOSEPH P. QUINLAN

U.S. and European Affiliate Sales vs. Trade - 1



Source: Bureau of Economic Analysis

U.S. and European Affiliate Sales vs. Trade - 2



Source: Bureau of Economic Analysis

of the Atlantic in excess of \$300 billion, US and European affiliates—even in a bad year—generate more economic output every twelve months than most countries. On a global basis, the gross product of US affiliates slumped to \$583 billion in 2001, down from \$606 billion in 2000. Europe accounted for roughly 55% of the total.

2. *Overseas Assets of Foreign Assets*

Corporate America's overseas commercial presence as measured by foreign assets totalled \$5.8 billion in 2001, with the bulk of these assets located in Europe. Total US assets in Europe exceeded \$3.3 trillion, representing roughly 60% of the global total. The largest share of US assets are in the United Kingdom, America's long-standing favourite destination in terms of foreign investment. US assets in the United Kingdom—roughly \$1.4 trillion in 2001—were more than 50% larger than the entire US asset base in Asia. In Germany, US assets of \$320 billion were greater than total US assets in South America. As for foreign assets held in the United States, European firms held some \$3.7 trillion in US assets in 2001, nearly 70% of the total. The geographic reach of Europe's investment in the United States is quite diverse. In fact, European companies are the top foreign investor in 45 states, and ranked second in the remaining five states in 2001.

3. *Affiliate Employment*

The transatlantic workforce deployed by US and European foreign affiliates is massive, totalling over 8.4 million workers in 2001. That is three times the number of total workers employed by US affiliates in Nafta partners Canada and Mexico (2.8 million). It is also well above total foreign employment of US foreign affiliates in Asia and Asian foreign affiliates in the United States (2.3 million).

On a global basis, US foreign affiliates employed nearly 9.8 million workers in 2001, with roughly 43% toiling in Europe. US majority-owned affiliates employed some 3.8 million workers in Europe in 2001, with the workforce evenly split between manufacturing employment and services. While the number of manufacturing workers in Europe as a percentage of the global total of US affiliates has levelled off in recent years, US firms still employed 1.9 million manufacturing workers in Europe in 2001. That is more than double the number of manufacturing workers employed by US affiliates in Asia. The transportation equipment sector was the largest source of manufacturing employment in Europe; wholesale employment was among the largest sources of service-related employment, and includes employment in such areas of logistics, trade, insurance and other service-enhancing activities.

European affiliates employed roughly 4.3 million American workers in 2001, slightly more than US affiliate employment in Europe. The top five employers in the US were from the United Kingdom (1.1 million), Germany (734,000), France (578,000), the Netherlands (571,000) and Switzerland (546,000). Out of the

6.4 million US workers on the payrolls of foreign affiliates in 2001, European firms accounted for roughly two-thirds of total employment. As a footnote, the figures cited above understate the employment effects of investment in that the numbers are for direct employment only, and do not include indirect employment related to non-equity arrangements like strategic alliances, joint ventures and other deals. Moreover, affiliate employment figures do not include jobs supported by trade with Europe. Employment related trade is substantial in many states. In total, and adding in indirect employment, we estimate that the transatlantic work force numbers some 12-14 million workers.

4. *Research & Development (R&D) of Foreign Affiliates*

Foreign affiliate R&D has become more prominent over the past decade as firms on both sides of the Atlantic seek to share the costs of development, spread the risks and tap into the intellectual talent of other nations. Alliances, cross-licensing of intellectual property, mergers and acquisitions and other forms of cooperation have become more prevalent in the transatlantic economy over the past decade. Indeed, the advent and spread of the internet on both sides of the Atlantic has been key in bolstering greater R&D collaboration: interregional internet bandwidth between the North America and Europe is 3½ times greater than bandwidth between North America and Asia.

Asset-augmenting strategies of firms point to greater transatlantic economic activity in knowledge-based sectors of the economy. The R&D demands of both US and European firms dictate that companies tap into innovative talent on both sides of the ocean. The cyclical recession of 2001 took a toll as global R&D expenditures of US foreign affiliates declined to \$19.4 billion from \$20.4 billion in 2000, an expected outcome given the weak profit performance of many firms. In Europe, US foreign affiliate R&D totalled \$11.7 billion, down from \$12.9 billion, although Europe still accounted for roughly 60% of the global total. The United Kingdom, Germany and France, in that order, were the top three markets where R&D expenditures by US foreign affiliates were greatest. No comparable figures for Europe's R&D investment in the US are available. However, given America's highly skilled labour force and the research intensity of many European sectors (chemicals, telecoms, automobiles), European R&D expenditures in the US are substantial and dwarf expenditures spent by Asian counterparts, namely Japan.

As a recent example of expanding European R&D expenditures in the United States, Novartis, the Swiss pharmaceutical giant, recently opened a research and development centre in Boston, a strategic move designed to tap the intellectual capital of the greater Boston area. The move will bolster the innovative capacity of the firm, while providing high-paying jobs for American workers.

5. *Intra-firm Trade of Foreign Affiliates*

Foreign affiliate sales are the primary means by which transatlantic commerce is conducted. Cross border trade is a secondary means of delivery, although the modes of delivery—affiliate sales and trade—should not be viewed independently of each other. They are more complements than substitutes, since foreign investment and foreign affiliate sales increasingly drive and determine trade flows. A substantial share of transatlantic trade is classified as intra-firm trade or related party trade, which is cross border trade that stays within the ambit of the company—for instance when Siemens of Germany sends parts and components to Siemens North Carolina, or when a Dupont affiliate in Delaware exports a specialty chemical to an affiliate in the Netherlands. This type of trade is evident among countries or regions with deep, investment-led linkages, which defines the transatlantic economy. Accordingly, roughly 55% of US imports from the European Union consisted of related party trade in 2002. In the case of Germany, the percentage (66%) was even higher. Meanwhile, roughly 30% of US exports to Europe in 2002 represented related party trade. Related party trade also played a key role in shaping transatlantic trade flows in 2003.

6. *Foreign Affiliate Sales*

With over 20,000 foreign affiliates dispersed around the world, US firms easily derive more sales from foreign affiliates than exports. That is notably the case with Europe, with US foreign affiliate in Europe achieving sales of \$1.5 trillion in 2001 versus US exports of \$276 million to Europe in the same year. Of global foreign affiliate sales in 2001 (a record \$2.9 trillion), Europe accounted for just over 51% of the total. On a comparative basis, affiliate sales in Europe were more than double affiliate sales in the entire Asia/Pacific region in 2001. Affiliate sales in the United Kingdom alone (\$428 billion) exceeded aggregates sales in Latin America. While sales in China soared over the 1990s on account of surging US foreign direct investment, sales of only \$36 billion in China in 2001 were on par with total sales in Sweden (\$33 billion) and well below sales in both Germany (\$240 billion) and France (\$135 billion).

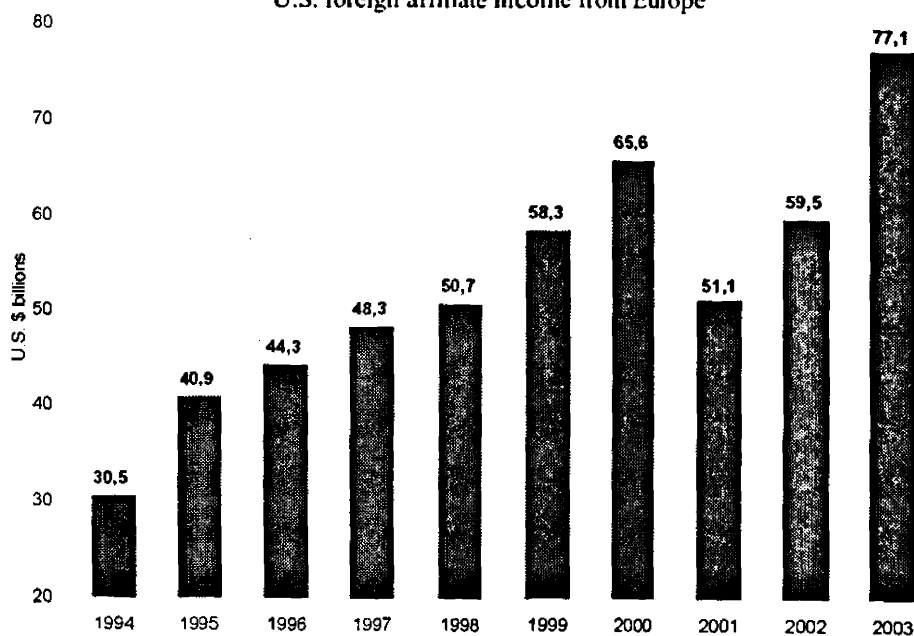
Affiliate sales are also the primary means by which European firms deliver goods and services to US consumers. In 2001, for instance, European affiliate sales in the US (\$1.4 billion) were over four times larger than US imports from Europe. In the case of the United Kingdom, the gap between affiliate sales and imports was even wider, with UK affiliate sales in the US more than five times the amount of US imports from the UK. German affiliate sales in the US were more than four times greater than US imports from Germany—a striking statistic for Germany, a country commonly thought to be a classic “trading” nation.

7. Foreign Affiliate Profits

In terms of profits, Europe remains by a wide market the most important region in the world for corporate America. Indeed, US corporate profits soared to record highs in 2003 due in large part to US dollar weakness, which helped inflate the bottom line of many US multinationals and drive the major US financial indices to robust levels. It was the US dollar's weakness against the euro—with the greenback depreciating by over 20% against the euro in 2003—that provided the most bang for the buck to US firms, since Europe typically accounts for half of US global earnings (earnings outside the US). For all of 2003, US foreign affiliate income from Europe, a proxy for global earnings, topped a record \$82 billion, up about 30% from the prior year. In the United Kingdom, the sharp slide of the US dollar against the British pound helped boost affiliate earnings by 18.4% in 2003. In all, US affiliate earnings in some twelve European markets (France, the Netherlands, Switzerland, Italy, Ireland, Spain, Belgium, Denmark, Sweden, Austria, Czech Republic, and Poland) reached record highs in 2003.

The U.S. Earnings Boost From Europe

U.S. foreign affiliate income from Europe

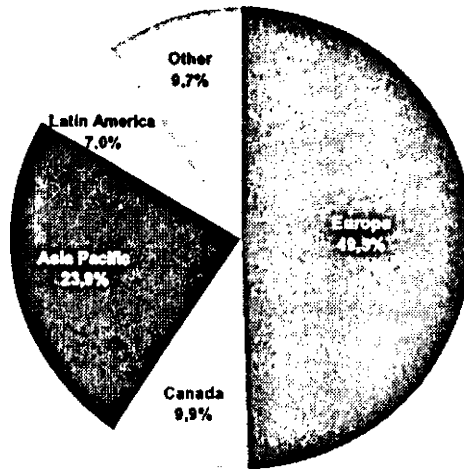


Source: Bureau of Economics Analysis

Partners in Prosperity: The Changing Geography of the Transatlantic Economy

Similarly, the United States remains the most important market in the world in terms of earnings for many European multinationals. Profits of European foreign affiliates in the United States also reached new highs in 2003, also sparking solid gains across various Europe stock markets. European affiliate profits totalled just over \$44 billion in 2003, with the earnings boost driven by strong US demand, which offset the adverse price effect from the strength of the euro and pound. British, Dutch, Swedish and Swiss foreign affiliates all enjoyed record US profits in 2003. Contrary to most assessments of transatlantic drift since the end of the Cold War, Europe's investment stake in the US has deepened dramatically since the fall of the Berlin Wall: European affiliates' earnings rose ten-fold between 1990 and 2003, or from \$4.4 billion to \$44 billion.

U.S. Foreign Affiliate Income Breakdown, 2003



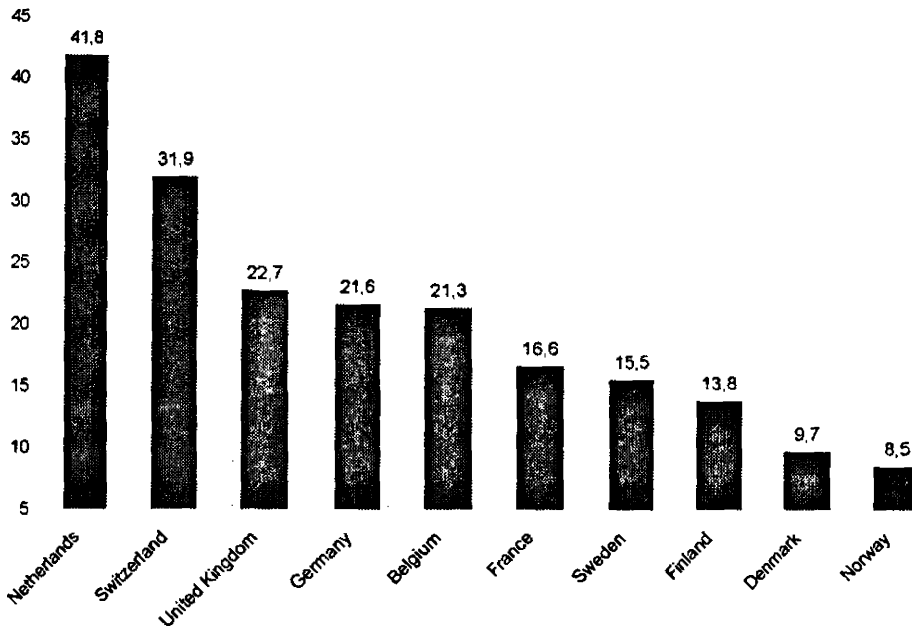
Source: Bureau of Economic Analysis

European sectors most exposed to the US market include automobiles, media, financial services and pharmaceuticals. In the pharmaceuticals sector, revenues from the North American market, namely the United States, accounted for 52.2% of total global revenues in 2002, according to figures from Morgan Stanley. In the same year, Europe's media sector derived some 38% of total revenue from North America; Europe's financial service sector, meanwhile, relied on North America for 36% of total revenue in 2002, while European automobile manufacturers generated nearly 30% of total revenues from North America.

In terms of individual European countries, the Netherlands is the most exposed to the North American market, according to survey results from Morgan Stanley, deriving some 41.8% of total revenue from North America in 2002. Ireland (32.5%), Switzerland (31.9%), the United Kingdom (22.7%), Germany (21.6%), and Belgium (21.3%) were also significantly exposed to the North American market.

Europe's Exposure to North America

Share of total revenues generated by North America, 2002



Source: Morgan Stanley

In sum, these seven indices convey a more complete and complex picture of international economic flows than simple tallies of exports and imports. Foreign direct investment represents the backbone of the transatlantic economy, with other variables such as overseas assets, affiliate employment and sales, and R&D all derived from the level and depth of investment linkages. No other commercial artery in the world is as integrated and fused together by foreign investment, a fact lost on many pundits, parliamentarians and policy makers on both sides of the Atlantic.

Comments

Hugo Paemen

When, in 2003, the Center for Transatlantic Relations published Joseph Quinlan's first survey of the Transatlantic Economic Relations ("Drifting Apart or Growing Together? The Primacy of the Transatlantic Economy"), it reminded us of the fact that, notwithstanding the growing importance of other economic actors in the world, the US and Europe have remained—and have increasingly become—each other's major bilateral partner in their exchanges of goods, services and investment. The new and extended survey, done jointly with Dan Hamilton ("Partners in Prosperity: The Changing Geography of the Transatlantic Economy"), consolidates this assessment. On the much belabored "drifting apart" theme, the authors conclude their Executive Summary with the observation that "In sum, the years since the fall of the Berlin Wall have witnessed the greatest period of transatlantic economic integration in history. Our mutual stake in each other's prosperity and success has grown dramatically since the end of the Cold War...". This trend seems to continue, as appears from the figures for 2003, despite the transatlantic acrimonies over trade disputes or the US-led war in Iraq.

One of the most interesting observations of the Quinlan/Hamilton survey, is the special link between trade and investment. As the sequential relationship between the two activities has largely changed in the globalizing economy, and even more so in the transatlantic market, the development of the one cannot be correctly assessed without taking into consideration the situation of the other. The best illustration of this connection is their finding that, in both directions, affiliate sales have become three to four times larger than direct exports.

Evenly interesting is their finding that these two so-called mature economies are also each other's most profitable markets. The same can be said of their mutual job creation. While, on a global basis, US companies employ more workers overseas (nearly 9.8 million) than foreign firms employ in the US (6.4 million), the European companies employ more workers in the US (4.2 million) than American firms do in Europe (3.2million)

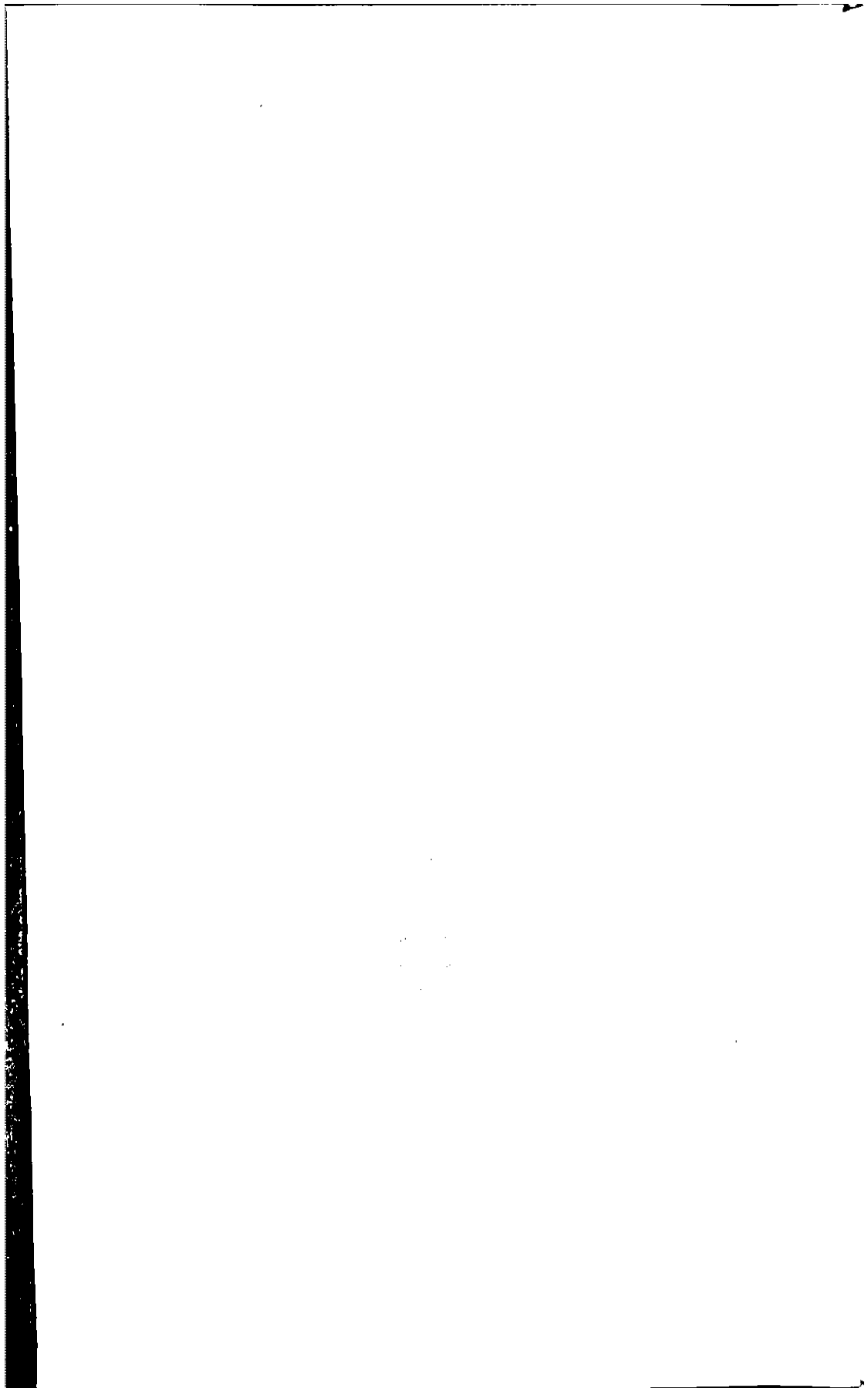
The new survey is greatly enriched by providing us with regional data for the individual States in the US, for the EU Member States, the sub-federal states in Germany and even for the recently acceded states of Central and Eastern Europe. Many interesting comments can be derived from the wealth of economic data. The overall impression is that of a progressive integration of the two economies. In the US this integration is confirmed by the near "invisible" foreign character of the European investments, while in Europe the American investors have wisely followed the developments linked to the gradual enlargement of the Union, which notably appears from the progressive geographic re-orientation of their new investments following the accession of new Member States.

The data of the Survey are convincing and reassuring for all those who care about the Atlantic Relationship. For that reason, the answers to three categories of questions, which are outside the scope of the present Survey, could usefully complete, or possibly qualify, the overall positive assessment by the Survey of the Transatlantic economy:

- 1) While most of the European investments in the US are in the manufacturing sectors (with the car industry representing the larger share), the orientation of American investments in Europe has considerably changed over the years, as has been clearly illustrated in the survey. From being fairly balanced between manufacturing and services until the early 1990s, US investment in Europe now seems to be largely geared toward services. In 2002 nearly three-fourths of the total investments seems to have taken place in services sectors. The employment situation shows the same shift: service employment by US affiliates in Europe more than doubled during the last decade. It appears that US investment in Europe has shown a high degree of flexibility and a capacity to adapt its strategic focus to the changing structural and political developments on the European continent. There do not seem to be indications of the same degree of flexibility of the European investment activities in the US. It would be interesting to know in how far such a comparison is justified and what the conclusion would be. In other words, a study and comparison of the "quality" of the investment and trading flows would be a valuable complement to the interesting information already collected by Quinlan and Hamilton.

- 2) A second question is somehow linked to the previous one. It concerns the longer term impact which the continuation of a divergent economic growth pattern in the US and Europe would have on the trade and investment relationship. In that respect the data on the already substantially divergent per capita GDP in the US and Europe, mentioned by Frederik Bergström and Robert Gidehag in *US vs. EU* (June 2004), should be examined. In how far would they encourage a somewhat more qualified assessment of the—longer term—state of the transatlantic economy?
- 3) Thirdly, the inevitable question of the possible contamination of the economic relationship by the acrimonious political atmosphere has become an increasing concern of business leaders on both sides of the Atlantic. Especially global companies, which expect and are prepared to deal with the political, legal and regulatory difficulties in certain parts of the world, loathe the thought of being confronted with a resurgence of trade disputes over the Atlantic. The (mainly political) future alone will tell us how this will finally turn out. In the meantime, we should be encouraged by certain developments in some sectors of the transatlantic dialogue, like financial services, auditing, trade, homeland security and others, which underneath the ominous political clouds seem to justify a more positive mood.

Joseph Quinlan can claim credit for having reminded the two sides of the Atlantic and the rest of the world of the central role of the transatlantic exchanges in the world economy. His statistical compilation and analysis give an impressive picture of the integration already achieved by the two economies. It would be particularly useful if, based on the data in his two surveys, some further economic analysis were to be made, which would allow for a more qualitative assessment of the transatlantic integration process.



Chapter 3

Trade Negotiations

Bruce Stokes

I. Introduction

The Atlantic Alliance, tested in wars both hot and cold, faces new challenges in the first decade of the 21st century. But while the 20th century challenges were largely security related, today's challenges are increasingly economic: how to deepen the integration of the emerging transatlantic marketplace and how mutually to maximize the benefits of the global trading system. How the United States and the European Union manage their bilateral and multilateral trade relations in the years ahead will shape the future nature of the transatlantic relationship.

II. History and Performance

The US and EU have a long history of cooperation in both the multilateral and bilateral trade arenas, at times achieving great success, at times experiencing embarrassing failures.

Europe and the United States created the General Agreement on Tariffs and Trade and drove successful tariff cutting negotiations in the GATT. It was Washington and Brussels that cooperated in 1986 to launch the Uruguay Round of multilateral trade talks, that brokered the Blair House agreement on agriculture in 1992 that broke the Round's deadlock and that jointly agreed on the shape and function of the World Trade Organization.

It was Robert B. Zoellick, the US Trade Representative and Pascal Lamy, the European Union's trade minister who jointly drove the launch of the WTO's current Doha Round. They worked to craft a development agenda to insure Third World support for the negotiations. In the wake of the disastrous failure to initiate a round in Seattle in 1999, they realized that disputes that divided rather than united WTO member countries—disagreements over labour rights, over the details of an agricultural agreement, over investment and competition policy—should be swept under the rug, to be dealt with at a later date. It has been the United States and the European Union that drafted a joint agricultural reform proposal before the WTO's 2003 ministerial in Cancun. And it was Europe giving up export subsidies and America agreeing to cut domestic farm support that forged agreement August 1, 2004 on a framework to continue the Doha negotiations.

But this cooperation, as useful as it has been, is increasingly demonstrating its limitations. No longer can Brussels and Washington dictate outcomes in multilateral settings. This was demonstrated in Cancun, when the US-EU proposal was roundly rejected. And it will be tested again next year when negotiators attempt to finalize the Doha agreement.

Bilaterally, in December, 1995 the European Union and the United States signed the New Transatlantic Agenda that created a new partnership framework that included a commitment to expanding world trade, to closer economic relations and to building bridges across the Atlantic.

In the NTA Brussels and Washington promised to:

Create a New Transatlantic Marketplace by progressively reducing or eliminating barriers that hinder the flow of goods, services and capital between us. We will carry out a joint study on ways of facilitating trade in goods and services and further reducing or eliminating tariff and non-tariff barriers. We will strengthen regulatory cooperation, in particular by encouraging regulatory agencies to give a high priority to cooperation with their respective transatlantic counterparts, so as to address technical and non-tariff barriers to trade resulting from divergent regulatory processes. We aim to conclude an agreement on mutual recognition of conformity assessment (which includes certification and testing procedures) for certain sectors as soon as possible. We will continue the ongoing work in several sectors and identify others for further work.

This NTA built on the Transatlantic Business Dialogue established earlier that year, which included both European and American business leaders. They committed themselves to work with government to remove barriers to trade through a building block approach, identifying particular impediments and cooperating to remove them.

Trade Negotiations

In 1998, the EU and US signed the Transatlantic Economic Partnership, which involved a wide range of bilateral co-operative actions and a regular dialogue on multilateral trade policy issues. Under the TEP, they have subsequently concluded agreements to remove technical barriers to trade by mutual recognition of conformity assessment, and worked together on customs procedures.

The TABD and the NTA reflected a commitment by the Clinton Administration to put US-European Union relationship at the center of American efforts to liberalize trade globally. The extent of the administration's willingness to make the EU America's primary interlocutor on trade in Europe was unprecedented. And it was a high mark of US-EU ambition and cooperation on the transatlantic marketplace.

Since then, the TABD has gone through debilitating internal change, with business leaders questioning its effectiveness and the value of their participation. In its latest incarnation, in 2004, the TABD urged Washington and Brussels to pursue creation of a barrier-free transatlantic market.

The TABD, the NTA and the TEP have served useful purposes. They symbolize an official recognition of the importance of the deepening transatlantic economic relationship. If they did not exist, someone would propose inventing them. But they have fallen far short of expectations.

But, until recently, the TABD had devolved into narrow discussions about individual problems affecting a small number of active companies. Lost in the weeds, the TABD lacked strategic impact. The building block approach to creating a transatlantic marketplace was widely discredited.

Nevertheless, the NTA and TEP have forced officials on both sides of the Atlantic to focus energies on bilateral concerns. They facilitated bureaucratic interaction, a useful process. And combined with the TABD, this structure has enabled the United States to communicate its concerns more directly to EU member states—on services issues for example—and vice versa. This ability to bypass the Commission is widely appreciated in Washington if not Brussels. But this dialogue was not useful in expanding the transatlantic agenda to include needed issues such as competition policy or health and safety standards. And the mutual recognition agreements and other groundbreaking ambitions of the initial signatories of the NTA and TEP have been frustrated.

III. Primary Impediments to Transatlantic Success

A. Structural Problems

Structural differences that have nothing to do with trade and everything to do with the differing natures of the European and American systems of governance have proven to be an ongoing impediment in transatlantic trade relations.

The federal nature of the United States has, at least up until now, created far clearer lines of authority and responsibility for trade issues than has the looser nature of the European Community/Union. To paraphrase Henry Kissinger's critique of the European Community, on trade matters there is a telephone number to call in Brussels, but when someone answers its not clear if he or she speaks for the European Commission or for Europe. The Commission ostensibly has trade competence, but the member states have a far greater say in trade matters than do individual US states.

Moreover, the Commission is still a work in progress, attempting to grow its authority and responsibility and to articulate a European point of view and set of interests. From an American perspective, this has at times led the Commission to strike a posture in international negotiations that is all about demonstrating to the member states that the Commission can do more to balance outcomes than the member states could have done themselves. This often leads to least common denominator negotiating positions and rigid stances that can't be changed because they are based on very fragile internal EU compromises. At other times, this need to define itself has led the Commission to take the bit in its teeth and run with an issue despite misgivings by member states. The Commission's insistence on pursuing the FSC case against the United States—when the EU challenged how the United States taxed the overseas profits of its multinational corporations—is just one example of this arguably shortsighted self-assertiveness.

From a European point of view, the gravest US structural defect may be the insidious role campaign money plays in American politics. The transatlantic banana dispute in the 1990s arose because of major campaign contributions by the chairman and CEO of Chiquita International Brands, Inc., and affiliated companies and executives to key Republican members of Congress and to the Clinton presidential campaign. Similarly, various US administrations have repeatedly refused to negotiate cabotage—the right of foreigner shipping interests to transship goods between US ports—because of targeted campaign contributions to key Congressional committee members by the US maritime industry that wants to keep such rights to itself.

There is also a transatlantic imbalance in the relative bureaucratic weight of the EU trade commissioner and the USTR. Trade has always been a big portfolio in Brussels, if only because it is one of the Commission's few clear competencies. USTR is weak bureaucratically—with roughly 200 staff members it is relatively small by Washington standards. And the agency is even more out of the loop politically. At times, because of the USTR's personal relationship with the president—when Robert Strauss was USTR in the Carter Administration, when Mickey Kantor was USTR in the Clinton Administration—the USTR has had real political clout. But Zoellick is known not to be close to President George W. Bush and this hurt Zoellick politically, diplomatically and bureaucratically.

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Going forward—as bilateral trade issues increasingly involve negotiation over domestic regulations—American federalism may prove less of an asset to the United States in trade deliberations. US states have jurisdiction over much public procurement, over many services—they regulate insurance—and they certify many professionals—such as lawyers. Already a number of states are denying USTR the right to unilaterally commit them internationally on public procurement issues.

B. Differing Authorizing Environments

The profound difference in bureaucratic and political settings in which EU and US trade officials must operate in Brussels and Washington has proven an ongoing obstacle to closer transatlantic cooperation on trade.

The US constitution gives Congress control over international commerce. As a result, all changes in US domestic law necessitated by trade agreements must have Congressional approval. To facilitate this process, since 1974, subject to periodic renewal, Congress has agreed to forego its right to amend trade legislation brought before it and to vote up or down on trade deals. This concession comes at a price, growing Congressional oversight of trade negotiations. This “fast track” trade negotiating authority must be renewed again in the first half of 2005 and will undoubtedly come with a number of bells and whistles.

Congress’ role in trade policy keeps any USTR on a short leash. It means he or she must be particularly responsive to Congressional concerns. And when a USTR lacks Washington political skills—a problem that dogged Zoellick—the resulting antagonism between USTR and Capitol Hill can limit the USTR’s freedom of manoeuvre.

This unique structural aspect of US trade policy making means EU trade commissioners spend an increasing amount of time lobbying Capitol Hill on trade issues ranging from tax policy to food health and safety. They must constantly confirm with key members of Congress what a USTR is telling them. It also means that EU trade sanctions against the United States often are tailored, in part, to influence particularly pivotal members of Congress.

The EU trade commissioner’s authorizing environment poses its own problems for the United States. The EU Commission has a mandate to negotiate internationally for the member states on traditional trade issues. But the lack of a clear mandate to negotiate on services caused repeated problems in the Uruguay Round. Moreover, American negotiators complain that the Commission’s lack of day-to-day accountability has led it to strike postures that reflect a Commission point of view, which often turn out to not have the support of the member states at the end of the day. Going forward, the evolving nature of EU competence will continue to pose difficulties, as it has in recent years in efforts to strike an EU-US open skies agreement.

BRUCE STOKES

The emerging role of the European Parliament and its growing interest in trade policy—especially now that Parliament will have a separate trade committee—poses new challenges—not dissimilar to those USTR faces with Capitol Hill—both for the EU trade commissioner and for American negotiators attempting to gauge his or her negotiating leeway. Moreover, it's the Parliament's actions—on beef hormones, on GMOs, on animal welfare and the testing of chemicals—that are increasingly the actions that trigger transatlantic trade disputes. It was not coincidental that Zoellick spoke before the EU Parliament before he spoke to Congress. US trade negotiations will have to spend more and more of their time dealing with Parliament.

But problems associated with different authorizing environments are not limited to the trade portfolio. The EU farm commissioner has purview over agricultural policy, the central conflict in the Doha Round. Similarly, the US Department of Agriculture controls American farm programs. But to complicate matters, US farm trade negotiations are run out of USTR. Lamy and Franz Fischler, the EU farm commissioner, have done a fair job of coordinating their positions. But US agricultural secretary Ann Veneman has not been a player in the Doha Round as secretary Dan Glickman was during the Clinton Administration on a variety of bilateral trade issues. This void has been filled by the US Congressional agricultural committees, which have long been fiefdoms unto themselves and wrote the trade-distortionary 2002 US farm bill on their own with no input from Veneman. Any future WTO deal on farm subsidies will necessarily require Congressional assent, which will prove no easy task.

C. Personality

Bad blood is repeatedly cited by trade negotiators on both sides of the Atlantic as a serious complicating factor in transatlantic relations in the 1990s. Sir Leon Brittain, EU trade commissioner, and USTR Mickey Kantor—two aggressive lawyers, neither of whom had a background in trade—had a prickly relationship in the first Clinton years. When Charlene Barshefsky, who had been Kantor's deputy, took over for Kantor in the mid-1990s, Americans believe Brittain could never accept her as his equal, creating very awkward moments. It was this personal antagonism that may have contributed to Barshefsky not taking seriously Brittain's suggested proposed transatlantic trade deal. Americans also believe that Sir Leon so irritated a significant minority of EU member states that Washington was never sure of his political mandate on particular issues. This was evident during the telecommunications and financial services talks in the WTO or when Brittain proposed a transatlantic trade agreement only to have the French reject it. Europeans, for their part, felt Kantor always couched every decision in the context of re-electing Clinton and that Barshefsky had the narrow mentality of the anti-

dumping lawyer that she had been in private life and that she lacked a broader diplomatic perspective.

Personal differences have also wrecked havoc at the career staff level. The appointment of Peter Carl in 2000 as the EU trade ministry's director general was greeted with dismay in Washington. Carl was viewed as anti-American and the single most combative European that American trade negotiators had faced in recent times. It was Carl who masterminded Europe's successful World Trade Organization case against US tax breaks for American multinational corporations. US trade officials felt the case broke a gentlemen's agreement not to attack each others' tax regimes and that it was filed out of pique over the US WTO cases on bananas and beef hormones.

D. Cultural Differences

Finally, veteran negotiators acknowledge that cultural differences—contrasting European and American attitudes toward negotiation—have frequently frustrated one side or the other.

Americans tend to see issues as problems to be solved, not managed. And they claim Europeans are often more interested in outmaneuvering their counterparts than in resolving disputes. Europeans see themselves as more willing to take a longer view and to manage problems not ready for solution. Europeans claim Americans are prone to wrap themselves in ideological purity and strike grandstand negotiating stances—such as initially calling for the elimination of all farm subsidies in the late 1980s or all industrial tariffs at the start of the Doha Round. Americans see Europeans as jealous defenders of the status quo. Europeans say Americans are on an extremely short political leash, too responsive to being jerked around by special interests. Americans say European Community officials as often out of touch with member state interest, pursuing a European Commission rather than European member state agenda.

IV. What Has Worked

A. Personal Ties

The personality and experience of trade officials, rather than bureaucratic structures or formal cooperation mechanisms, is cited again and again by trade experts in both Washington and Brussels as the single most important attribute in effectively managing the transatlantic trade relationship in recent years.

Hugo Paemen, the EU negotiator in the Uruguay Round and subsequently the EU ambassador in Washington in the 1990s, consistently wins high praise for his adroit management of the trade relationship, often skillfully navigating waters that had been riled by senior trade officials. His long experience in the trade field and

his diplomat's touch were often a useful counter balance to the lack of international trade experience and hard-nosed negotiating style of Sir Leon Brittain, Mickey Kantor and Charlene Barshefsky.

Stuart Eisenstadt, the Clinton Administration's first ambassador to the European Union, had political ties in Washington that made him a player in US-EU relations unlike most of his predecessors or his successors. His vision and ambition for the relationship helped energize American interests and was instrumental in issuance of the New Transatlantic Agenda and the creation of the Transatlantic Business Dialogue. In subsequent posts in the Clinton Administration—as undersecretary of Commerce for international trade, as undersecretary of State for economic affairs and as deputy Treasury secretary—Eisenstadt's follow up on these initiatives proved invaluable, demonstrating another important attribute to successful relationship management: longevity and continuity.

The trade experience, shared strategic vision, long-time friendship and personal compatibility of USTR Zoellick and EU trade minister Lamy was undoubtedly the defining element of US-EU trade relations in the first Bush Administration.

Lamy and Zoellick got to know each other as sherpas for the G-7 summits in the 1980s. They continued their personal relationship while pursuing business careers in the 1990s. Despite differing political backgrounds—Lamy is a French socialist, Zoellick a Republican—they shared a commitment to the importance of open, internationally competitive markets. They both came to office with experience at high levels of government: Lamy the former chef de cabinet for EU president Jacques Delors and Zoellick the former counselor to US Secretary of State James Baker. And both had private sector experience in the financial services sector. Unlike most of their predecessors, they were grand strategic thinkers. But they were also pragmatic deal makers. Both men were cerebral and intense—sharing a passion for long distance running. They were personally very ambitious and young enough to see their trade jobs as stepping stones to even more influential posts. And they shared a fatal flaw, neither was a very good domestic politician and both lacked some of the necessary influence in Brussels and Washington.

Their personal ties and shared world view and operating style is widely credited with enabling Zoellick and Lamy to settle the long-festering US-EU dispute over the European banana import regime. Washington objected to the regime because it discriminated against imports from nations in Central and South America where US growers had investments. The United States had won a WTO judgement against the EU and Brussels was paying damaged rather than change practices. The dispute had become a cause célèbre on both sides of the Atlantic, particularly irritating President Bill Clinton. Defusing the issue demonstrated that Lamy and Zoellick could do business, unlike their predecessors. It meant that they intended to do bigger things, not trifle with irritants. And it shrewdly created the perception that their friendship

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was their ace in the hole, a not insignificant public relations asset in a media-driven age when perceptions are often as important as reality.

That perception subsequently served them well. It created an aura of transatlantic solidarity that helped launch the Doha Round of multilateral trade negotiations in late 2001, in the wake of the September 11 terrorist attacks when many trade experts thought the world was not ready for such an initiative. It prevented the bitter US-EU fight over the Bush Administration's imposition of steel tariffs in 2002 from undermining cooperation on other issues. And it helped both sides manage a potentially explosive and expensive trade war over the imposition of European tariffs on US products because of US taxing policies.

Notwithstanding the demonstrated importance of close personal ties in achieving transatlantic trade cooperation, the current cult of personality that built up around the relationship between Zoellick and Lamy exaggerated the significance of such ties between trade negotiators in general. Bitter personal foes have accomplished a great deal when key US and EU economic interests were at stake. And no amount of personal chemistry can settle some disagreements.

Despite barely being on speaking terms, Charlene Barshefsky and Sir Leon Brittan presided over successful completion of multilateral negotiations to liberalize global financial services and telecommunications markets. They worked together to pass the information technology agreement, which eliminated tariffs on \$500 billion worth of trade when it was signed in 1996.

It is true that the financial services and telecommunications deals were teed up for completion at the end of the Uruguay Round. And much of the credit for these successful agreements can also be attributed to Barshefsky's and Brittain's deputies, who actually negotiated the deals. But this can be said for almost any trade agreement. And it is disingenuous to blame the bad blood between Barshefsky and Brittain for all the problems in transatlantic trade in the late 1990s, while ignoring all that was accomplished on their watch. Despite the dominant folklore among trade experts, their successes in transcending their personal differences arguably exceeded their failures.

Similarly, the Lamy-Zoellick relationship has demonstrated serious limitations. Their ties may have facilitated defusing a \$100 million banana dispute, but they were powerless to avoid the subsequent \$4 billion confrontation over differences in the taxation of multinational corporations, which was not resolved until the very end of their tenure. Nor were they able to avoid ongoing friction over hormone treated beef and GMOs.

Personal compatibility clearly matters in transatlantic trade relations, if only because the trade policy community believes it does and, more importantly, the press and thus the public have come to see it as important. But its not a panacea.

B. Trumping Bilateral Concerns with Multilateral Goals

Sublimating bilateral trade concerns to the broader multilateral good has repeatedly proven effective in breaking seemingly intractable transatlantic trade deadlocks. Trade officials in Washington and Brussels have shrewdly used impending global trade negotiations as a rationale to force compromise among their domestic interest groups to enable them to resolve issues that had theretofore proven intractable.

In 1986, newly-minted USTR Clayton Yeutter was laying the groundwork to launch what became known as the Uruguay Round trade negotiations. But a major obstacle to cooperating with Europe on the launch was a trade dispute triggered by the entry of Spain and Portugal into the European Community at the beginning of that year. Their entry had led to higher tariffs on imports of US corn and sorghum, and lost US sales of about \$500 million a year. Washington threatened retaliation against European agricultural products, wines and pasta. With all chances of launching a new trade round at risk if a transatlantic trade war erupted, Yeutter flew to Brussels and personally negotiated an end to the "Pasta War."

Similarly, Zoellick and Lamy realized that they needed to clear the decks of bilateral irritants if they were to have any hope of launching the Doha Round. Some problems, such as the tax dispute, were too big or too complex for easy resolution. But the banana dispute was ripe for solving. The WTO had ruled against the EU, so there was no reason to further delay settlement. Neither Washington nor Brussels had banana producers who voted. And the dispute had become a popular symbol of ridiculous trade bickering, the butt of jokes on American television. Both Zoellick and Lamy realized the symbolic political value of ending the fight, despite its economic insignificance, and they struck a deal in 2001. It is testimony to their insight that almost every subsequent journalistic account of their personal relationship cites resolution of the banana dispute as an example of the value of those ties.

C. Convergent Economic Interests

Convergence of interests has also been a driver of cooperation.

The Uruguay Round stumbled along for 6 years until the European Union and the United States reached the Blair House agreement on agriculture in November 1992. The deal fell far short of initial American ambitions but was the most the EU could stomach. It served US interests—particularly those of the service and intellectual property industries—to break the deadlock. And it enabled the EU to use international pressure to nudge forward reform of the Common Agricultural Policy.

In the first Clinton Administration USTR Kantor used to joke bitterly that in dealing with China, Brussels was more than willing to hold America's coat while the United States did the fighting. In particular, he resented Europe's unwillingness

to press China on protection of intellectual property rights, a dispute that led the United States to threaten massive retaliation against Beijing before obtaining promises of a crackdown on piracy, law enforcement that European firms would benefit from just as much as American companies.

But by the second Clinton Administration, when USTR Barshefsky was negotiating China's WTO accession, there was close cooperation between Brussels and Washington, with the principal US and EU negotiators talking on the phone once or twice a week. They double-teamed the Chinese on issue after issue. The US and EU positions were coordinated on services, tariff measures and anti-dumping among other issues.

More recently, Washington and Brussels jointly developed an agricultural proposal for the ill-fated WTO Cancun ministerial. While this US-EU effort was roundly criticized by developing countries—despite the fact that it was put together at their request—it served as the basis for post-Cancun agricultural deliberations, as evidenced by the coordinated European proposal to end export subsidies complemented by the US willingness to end export credits. Such proposals reflected a growing transatlantic convergence of farm interests that led to the Doha framework agreement in August, 2004.

V. Challenges Ahead

A. *Differences in Economic Interests*

Conversely, the greatest challenge facing future multilateral and bilateral transatlantic trade cooperation is differences in economic self-interest. Such differences have always existed and there is no conclusive means of testing whether they are greater or lesser now than they were in the past. Suffice to say there are differences and they will affect both the willingness to cooperate and the depth of that cooperation.

Throughout the post-war era, the United States has had a rising interest in the global economy and a more diverse set of regional interests than has Europe.

Both the European Union and the United States are primarily regional traders. For the United States, the plurality of its exports go to Canada and Mexico. For EU member nations, three-fifths of their exports go to each other. Beyond that, interests diverge. As a buyer of US exports, China's share of total US exports has grown 8 fold in the last half century and it now supplies a tenth of US imports. European trade with China has not grown nearly as much.

Similarly, Eastern Europe's share of Western Europe's exports has grown by half in recent years. US exports to Eastern Europe, as a share of total US exports, is static.

At the same time, one-in-six US exports go to Latin America, up from one-in-eight just a few years ago. Latin America's share of European exports has fallen from 4.5 per cent to 2.1 per cent, according to World Trade Organization data.

With a greater and growing stake in more regions of the world, its little wonder that the United States has pursued regional and bilateral free trade agreements with a range of nations: Mexico and Canada, Morocco and Bahrain, 5 central American republics and the entire Western Hemisphere.

Europe has hesitantly attempted to replicate this experience, with little success to date. Four years in to the EU-Mexican free trade agreement, the European market share in Mexican imports has increased only slightly, from 8.6 per cent in 2000 to 10.5 per cent in 2004. Brussels' effort to negotiate a free trade arrangement with the Mercosur countries of South America—Argentina, Brazil, Paraguay and Uruguay—has yet to bear fruit. But it has already generated transatlantic friction. Brussels allegedly offered Mercosur greater access to the European market in return for its cooperation in limiting the ambition of the Doha Round with regard to agricultural reform. This attempt to leverage cooperation drew howls of protest from around the world. Europeans retorted that they have long felt Washington used its expanding network of regional trade agreements to buy cooperation in multilateral negotiations. Whether the pot or the kettle is blackest is less important than the fact that regional trade entanglements are likely to increasingly preoccupy Washington and Brussels. The United States plans deals with Thailand, Peru, Ecuador and Colombia and various nations in the Persian Gulf are knocking on the American door. The EU will increasingly be preoccupied with Eastern Europe, Turkey and the former Soviet Union.

Recent Brussels' negotiations with Moscow over Russia's application to join the World Trade Organization are evidence of the kinds of tensions these differing regional interests could cause in the future. The EU had two key concerns in the deliberations. To force Russian producers to pay market prices for energy so that they will not have an unfair competitive advantage when exporting into the EU. And to get Moscow to sign the Kyoto global warming treaty. When the Russian government of Vladimir Putin acceded on those two issues, Brussels signed off on Russia joining the WTO. From the European point of view, as the buyer of 60 per cent of Russia's exports, Brussels was simply pursuing its self-interest. But this rush to settle embittered Americans in Washington. The United States still has aircraft tariff issues to settle with Russians, access to the telecommunications, banking and insurance markets and food health and safety issues to resolve. By settling with the Russians, the EU has put the onus of delaying Russia's WTO membership on the Americans. Compared with the close EU-US coordination of negotiations on China's WTO negotiation, this lack of coordination suggests Brussels' regional interests may now trump transatlantic cooperation, a possibility that does not bode

well as Europe deepens trade ties with North Africa, the Middle East, the Balkans, the Caucasus and Turkey.

B. The US Trade Imbalance

Another manifestation of differing interests going forward is embodied in the historically unprecedented US trade deficit, which is now approaching 5 per cent of the American GNP. International Monetary Fund studies show that no major industrial nation has ever sustained a current account deficit of this magnitude for long. Such imbalances have always ended badly. And while the United States may be able to sustain such deficits for longer than anyone else, thanks its size and the inherent strength and dominance of the American economy, history and the fundamentals of economics are ultimately likely to prevail and a correction will have to take place.

This need for the United States to correct its trade imbalance gives Washington compellingly different economic interests than Brussels. The United States needs to boost exports by opening markets abroad or else the correction will come disproportionately from a decline in US imports, through a weakening of the dollar and protectionism, both disastrous for the American consumer. This structural difference will inexorably lead Washington to press harder for market opening in developing countries, to be more confrontational with China and India and to fight Europe over new import barriers, be they bans on imports of GMOs or hormone treated beef.

Eventual correction of the US global trade imbalance is also likely to sour the transatlantic trade atmosphere. To date, discussion of the US deficit has focused on the bilateral imbalance with China and Japan. But the bilateral merchandise trade deficit with the Europe Union was \$94.3 billion in 2003 and is on a path to run a deficit of \$90.3 billion in 2004, second only to its deficit with China and worse than its imbalance with Japan. Since World War II, the US and Europe have prided themselves on balanced trade.

No more. The United States has now run a deficit with the European Union for 11 straight years, the longest stretch in post-war history. This imbalance has worsened each of these years, suggesting that even if it turns around, as it may in 2004, it could take another decade to rebalance. This is not now a political problem in the United States, but it could always become one. More important for Europeans, correction of this imbalance (and Europe will have to absorb some portion of the correction of the American global imbalance) will prove economically painful in Europe, with attendant resentment toward the United States and a weakening dollar or rising protectionism. This will not necessarily prove an atmosphere conducive to greater transatlantic trade cooperation.

C. Public Opinion

Broadly speaking, Europeans and Americans share similar views about the value of trade and globalization. Two-thirds of Americans (65 per cent) and British (67 per cent) and more than half the Germans (55 per cent) think globalization has been positive for themselves and their families' interests, according to a late 2003 survey by Globalscan Research Partners. Only in France do people disagree. Only a third (35 per cent) of the French see globalization in a positive light.

But such broad generalizations mask a politically important erosion in public support for trade, at least in the United States. The American farm community, long the cornerstone of the free trade coalition in Washington, is now wavering in the face of growing international competition from Brazil and elsewhere. A recent poll by the University of Maryland found that six-in-ten US farmers felt that other countries benefit more from trade than does the United States and a similar proportion felt that even if the new jobs that come from free trade pay higher wages, overall it is not worth the disruption of people losing their jobs. Given the disproportionate influence American farmers have in the US Senate, where Senators represent land not people, these changing attitudes can not be ignored looking forward to Senate approval of a Doha Round agricultural agreement.

Similarly, American white-collar workers, who have long thought they were immune from the challenges of globalization, now fear that their jobs will be shifted to India. This promises profound political ramifications. The same University of Maryland poll found that among white collar workers in America support for greater trade fell from 57 per cent in 1999 to 28 per cent today. More ominously, nearly half of the white-collar voters in the 17 American states considered to be the battle ground for the 2004 presidential election believe trade liberalization should actually be slowed, stopped or reversed, compared with only a third who feel that way in the country at large.

Pessimists in Washington worry that such declining support for trade liberalization among politically influential American constituencies will be interpreted by the next US administration as yet another reason to move slowly on both multilateral and bilateral trade cooperation with Europe. Optimists interpret Americans' support for trade in general as evidence that American voters are becoming more pragmatic about trade policy and less ideological. This could signal a convergence of European and American views on a range of trade issues, from farm policy to how far to go in opening markets to Third World products.

So far, the data hardly merits such optimism. There is no convergence on trade liberalization, at least as it relates to opening the US market to the developing world. Three-in-five Americans oppose allowing more food and clothing imports from developing countries if it would mean significant job losses. By comparison,

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three-in-five British and Germans would favor such imports, suggesting a divergence on the development goals of the Doha Round.

Differences in public attitudes toward the role of the United States in the world, toward transatlantic ties and toward each other also suggest differing political climates in Europe and the United States that will complicate deeper cooperation on trade issues.

Support for the United States among the core countries of the European Union has collapsed. Three-in-four (75 per cent) people in Britain had a favorable attitude toward America in the summer of 2002. In March, 2004, only three-in-five (58 per cent) held such positive views. Anti-Americanism is even worse on the continent. In France, favorable ratings for the United States have fallen from 63 per cent to 37 per cent in France and 61 per cent to 38 per cent in Germany, according to surveys done by the Pew Research Center for the People & the Press.

At the same time, European support for a more independent European foreign policy has grown. In April, 2002, 47 per cent of those surveyed in Britain by Pew supported Europe striking more of its own course in the world. By March, 2004, that proportion had grown to 56 per cent. Similarly, 75 per cent of the French wanted greater distance from the United States compared with 60 per cent two years earlier. And 63 per cent of the Germans wanted more independence, compared with 51 per cent in 2002.

Finally, transatlantic animosity, which has heretofore manifested itself only at a national level, has begun to get personal. Historically, in the 1960s, again in the 1980s and in the last few years, Europeans have differentiated between their episodic distaste for American policies while continuing to like Americans. Today, Europeans love affair with Americans as a people seems to be waning. In 2002, 83 per cent of the British had a favorable view of Americans, according to Pew. In 2004, only 73 per cent held such views. The falloff in support has been even greater in France, where in 2002, 71 per cent of the French held a favorable attitude toward the American people. Now only 53 per cent of the French are so positive. The animus is reciprocated in the United States. In 2002, 90 per cent of Americans held the British in high regard. In 2004, only 73 per cent had such sentiments. Support for the French fell from 79 per cent to 33 per cent and for the Germans from 83 per cent to 50 per cent.

For European politicians, such differences signal that there is little political benefit to be gained by greater cooperation with the United States in any realm, including trade. For American elected officials, there appears to be little public demand for working more closely with the Europeans, on greater trade liberalization or anything else.

D. Differing Values

Differences in public attitudes are complicated by transatlantic differences in public values. To the extent that trade differences reflect values' differences, some future transatlantic trade problems may prove particularly intractable.

Current and prospective US-EU fights over hormones in beef, over public procurement rules, over animal welfare and over how to price pharmaceuticals are not generated by old-fashioned protectionism, but by differences in collective preferences.

As transatlantic commerce has grown and evolved over the years, once largely value-free economic transactions involving commodities and manufactured products have increasingly been supplanted with commerce in services and products often laden with "ideological content [that pharmaceutical research and development should be funded through the marketplace, that scientific evidence is the only rationale for restricting trade in food stuffs] more sensitive to differences in collective preferences," according to a European Union discussion paper "The Emergence of Collective Preferences in International Trade." It is perceived threats to the diversity of such collective preferences that drives many current transatlantic disputes.

For example, Europeans have failed to comply with a 1999 WTO decision that requires the EU to have a scientific basis for banning imports of meat treated with hormones. Brussels asserts that EU consumers have a collective preference not to consume such meat because of concerns about its long-term health effects. And Europe has been paying more than \$100 million in sanctions per year as the price for such a preference.

Europe is also in the process of setting animal welfare standards for chickens, pigs and cows, specifying how much space each must be given in their cages, how many hours they can be transported before they get to rest and so forth. Once such rules are in force throughout Europe, farmers are bound to object to imports of American produce raised under less stringent and costly standards. And they are likely to argue that restricting such imports is the only way Europeans can successfully exercise their collective preference for protecting animal welfare when the EU's trading partners have different priorities.

On the other side of the Atlantic, in its recently negotiated free trade agreement with Australia, Washington demanded that Canberra end price controls on imported pharmaceuticals. Aussie trade officials refused, noting widespread domestic opposition to higher drug prices. The Bush Administration argued that the most effective way to fund R&D is through pharmaceutical prices set by the market. The Australians, and most European governments, believe that a free market drives prices so high that needed pharmaceuticals are out of the reach of too many

consumers. It is a classic clash of conflicting collective preference. It is only a matter of time before the United States raises this issue with the Europeans.

The greatest challenge facing transatlantic trade relations in the years ahead, predicted EU trade minister Pascal Lamy in a March 5, 2004 speech at a conference of the Greens/European Free Alliance at the European Parliament in Brussels, may be “how we organize market opening in such a way as to uphold the varying collective preferences of different societies?” It will require both Brussels and Washington to make tough choices, separating the wheat of collective preference from the chaff of self-interested protectionism masquerading as collective preference. It may necessitate self-restraint, with Washington not attacking European trade barriers it knows Brussels is politically incapable of removing. And it may require new international trade rules that would permit countries to defend their own social choices about global commerce—banning the imports of sweat-shop labor or capping the price of imported drugs—while compensating foreigners who are hurt by such actions.

VI. What Can Be Done?

A. Re-establish a Political Commitment

Transatlantic trade cooperation during the Cold War was driven by a shared perception that opening markets would foster economic growth, strengthen democracies and ward off Communism. That rationale is gone and no compelling motivation has replaced it.

Deepening transatlantic divisions over the unilateral conduct of American foreign policy, the war in Iraq, the war on terrorism, the Israeli-Palestinian conflict, the Kyoto global warming treaty and other issues have led to calls for closer US-EU economic cooperation—through a free trade area or some similar effort—to offset these tensions. So far, such proposals have fallen on politicians’ deaf ears and excited no interest among the public at large. Such proposals are intended to compensate for transatlantic differences in non-economic arenas rather than to pursue a jointly shared goal. With no consensus on that jointly shared economic objective, there is no political consensus on some grand transatlantic economic project.

At the same time, a technical, below the radar screen, building block approach to solving transatlantic trade problems one at a time has bogged down in minutia time and again, failing to capture public or political imagination.

Enhanced transatlantic trade cooperation will require overt political commitment at the highest level. In the 1990s, then US Speaker of the House of Representatives Newt Gingrich and then Senate majority leader Robert Dole both spoke favorably of creation of a transatlantic free trade area. Then European Union president

Jacques Santer and British Foreign Secretary Malcolm Rifkind propounded a vision of a transatlantic marketplace. And US Secretary of State Warren Christopher proposed a joint effort to bridge the Atlantic. It wasn't enough. When EU trade commissioner Sir Leon Brittain proposed a transatlantic free trade area, his idea was soundly rejected. It will take an explicit, shared public vision by both the president of the United States and the president of the European Union to energize their publics and their bureaucracies to take the next major step in transatlantic economic cooperation.

Without such commitment, US-EU cooperation will necessarily focus on marginal improvements in a largely successful working relationship.

B. Be Quick Off the Blocks

Even if a personal relationship does not exist prior to taking office, the next USTR and the new EU trade commissioner should move to establish one. Kantor met with Brittain three days after assuming his post. It didn't help, but it was the right instinct.

The experience of Pascal Lamy and Robert Zoellick suggests that early in their tenure, before they become personally bogged down in bilateral disputes that have arisen on their own watch, the EU trade commissioner and the USTR have a window of opportunity to accomplish joint efforts.

In early 2005 the new European and American trade czars should identify some low hanging fruit and harvest it. This may mean finally resolving the beef hormones or GMO disputes. Whatever the issue, the two trade leaders need to demonstrate early on that they can solve problems.

At the same time, they need to put their personal stamp on an EU-US agenda for their tenure. For Zoellick and Lamy this joint goal clearly was the launch of the Doha Round. For their successors it may be completion of the Round or, if that appears too difficult, some goal that shifts attention away from the impossible toward the achievable. If history is any judge, history will judge both, at least in part, by how they have handled transatlantic trade relations.

C. Create Space for Closer Bilateral Ties

When Charlene Barshefsky left office, she said one of her greatest regrets was not pursuing a free trade agreement with Europe. At the end of Zoellick's tenure, USTR is beginning "listening" sessions with stakeholders in the transatlantic marketplace, to assess how to strengthen ties.

Rather than regret not doing enough as they go out the door, the next USTR and EU trade commissioner should propose a transatlantic wisemen's group of elected officials, business leaders, former trade officials, security experts and representatives of non-governmental organizations to report back to them in

18 months about what kind of transatlantic marketplace is politically feasible and what needs to be done to get there. As part of this exercise, they should commission a study of the costs of *not* creating a single market between Europe and the United States.

D. Strengthen Ties with Each Other's Authorizing Environments

Zoellick spoke to the European Parliament in spring 2001, even before he addressed the US Congress. During his many trips to Washington, Lamy often spent more time talking to members of Congress than with Bush Administration officials. Groundwork for closer communication with the elected representatives of the people on both sides of the Atlantic has been laid. It needs to be built upon.

US and EU regulators need to talk more to each other. This has long been the case. But regulators on notoriously inward looking and domestically preoccupied. So, if the mountains won't come to Mohammed, then Mohammed must go to the mountains. The USTR and EU trade commissioner need to seize the initiative. They need to convene meetings between regulatory counterparts in Washington and Brussels and include the chairmen of their authorizing legislative committees. If the head of the US Food and Drug Administration thinks USTR will be talking pharmaceuticals with the Europeans, he or she may find the time to be part of the discussion.

USTR also needs to continue close working relationships with officials in the EU member states. The Commission will object, as it has in the past, but the Commission's competence on a range of future trade issues—those involving domestic regulatory matters—is still not clear. And Washington needs to maintain lines of communication to national capitals to insure America's self-interest is not a victim of internecine European power struggles.

E. Develop a Joint Multilateral Strategy

Brussels and Washington need to begin talk about what to do after the Doha Round. The Round will either be completed on the watch of the next USTR and EU trade commissioner—in 2006 or 2007—or it will peter out. In either case its not too soon to start thinking about what to do next with the multilateral system. Obviously a Doha failure will create more complications than a success, but even a successful outcome for the Round will be limited, given the compromises that have already been made and the negotiating problems to date. All this raises new doubts about the efficacy of further rounds in the future.

There has long been discussion about institutional change at the WTO, with Brussels pushing for more fundamental reform than Washington. This issue can no longer be ignored. To break the deadlock, it may be necessary for non-trade officials—diplomats and security experts with long international experience, a stake

in a more successfully functioning multilateral trading system, but no stake in the Geneva culture and tradition of the increasingly dysfunctional WTO—to be brought into the dialogue to make suggestions and put pressure on the system to reform.

At the same time, the EU and the US need to begin to evolve common approaches to dealing with the emergence of China and India in the world trading system, to the functioning and use of the WTO dispute settlement—where panels are increasingly creating new obligations that were never negotiated, undermining WTO support in both the business community and among the general public—and so forth. While such US-EU cooperation will increasingly draw cries of protest from the Third World—as it did when the EU and the US developed a new farm proposal for Cancun—Washington and Brussels can't afford not to defend their own self interests.

Finally, the EU and the US must jointly address the long-term implications—both for the multilateral system and for global business—of the proliferation of bilateral and regional free trade agreements that are leading to what former deputy USTR Jules Katz used to call a “spaghetti bowl” of rules of origin and conflicting regulatory obligations. With Japan, China and Brazil beginning to negotiate free trade agreements of their own, which do not include either the EU or the United States, Brussels and Washington need to decide if its time to regain some control over the Genie they have let out of the bottle. This may include new WTO disciplines on such trade deals.

F. Reassess the Needs of USTR and DG-Trade

Are USTR and DG-Trade up to these challenges? A new USTR and a new EU trade commissioner will be best positioned to make that assessment and implement changes.

In Washington, USTR as an agency has little institutional clout. But the USTR will be accorded political clout if he or she is perceived as speaking for the president. Zoellick suffered from the perception he lacked that line to the White House. Kantor benefited from his long-standing ties to Clinton. The next USTR should have an obvious and close personal relationship with the president to compensate for the agency's small size, bureaucratic coordinator's role and limited history.

In Brussels, trade commissioners have always had greater clout due to the Commission's competence in trade. But with the emergence of the European Parliament as a player on trade issues, with the emergence of a president of the European Council and the development of a common European foreign and security policy, the trade commissioner risks losing some relative power. This needs to be resisted.

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Finally, at a functional level, the next US administration needs to appoint a politically well connected ambassador to the European Union. It will send all the right signals and provide someone with a personal career stake in driving closer transatlantic ties. Similarly, the EU needs a politically attractive ambassador in Washington to be the public face for a Community that is still not well understood in the United States.

Comments

Ernst-Ulrich Petersmann

I largely share the analysis of the Transatlantic Economic Partnership (TEP) in sections I to V of Bruce Stokes' conference paper, albeit with some reservations concerning his criticism of the "short-sighted self-assertiveness" of the EU Commission's pursuit of the FSC dispute in the WTO. His conclusion that the TEP has "fallen far short of expectations," reflects the practical experience that transatlantic cooperation in the World Trade Organization (WTO), and the settlement of transatlantic disputes through WTO dispute settlement procedures, have proven effective and more important (e.g. joint EU/US leadership for advancing the multilateral Doha Round negotiations in the WTO) than complementary bilateral negotiations in the various TEP institutions. Bruce Stokes' policy conclusions, in section V on "What Can Be Done?," are not always convincing: The proposals to set up a "transatlantic wisemen's group [...] to report back [...] in 18 months about what kind of transatlantic marketplace is politically feasible," and to "commission a study of the costs of not creating a single market between Europe and the United States," appear premature up to the conclusion of the Doha Round negotiations, presumably only in 2007. The needed EU-US leadership for institutional changes in the WTO (e.g. enlargement of the WTO Secretariat, provision for powers of the WTO Director-General to initiate proposals and defend the collective WTO interests, creation of a small WTO Executive Body and of a comprehensive WTO Consultative Body, broader involvement of representative NGOs in WTO consultations) should not wait until the end of the Doha Round. Even though the Doha Round Work Programme does not include such institutional reforms, the experience with the similar situation in the Uruguay

Comments on "Trade Negotiations"

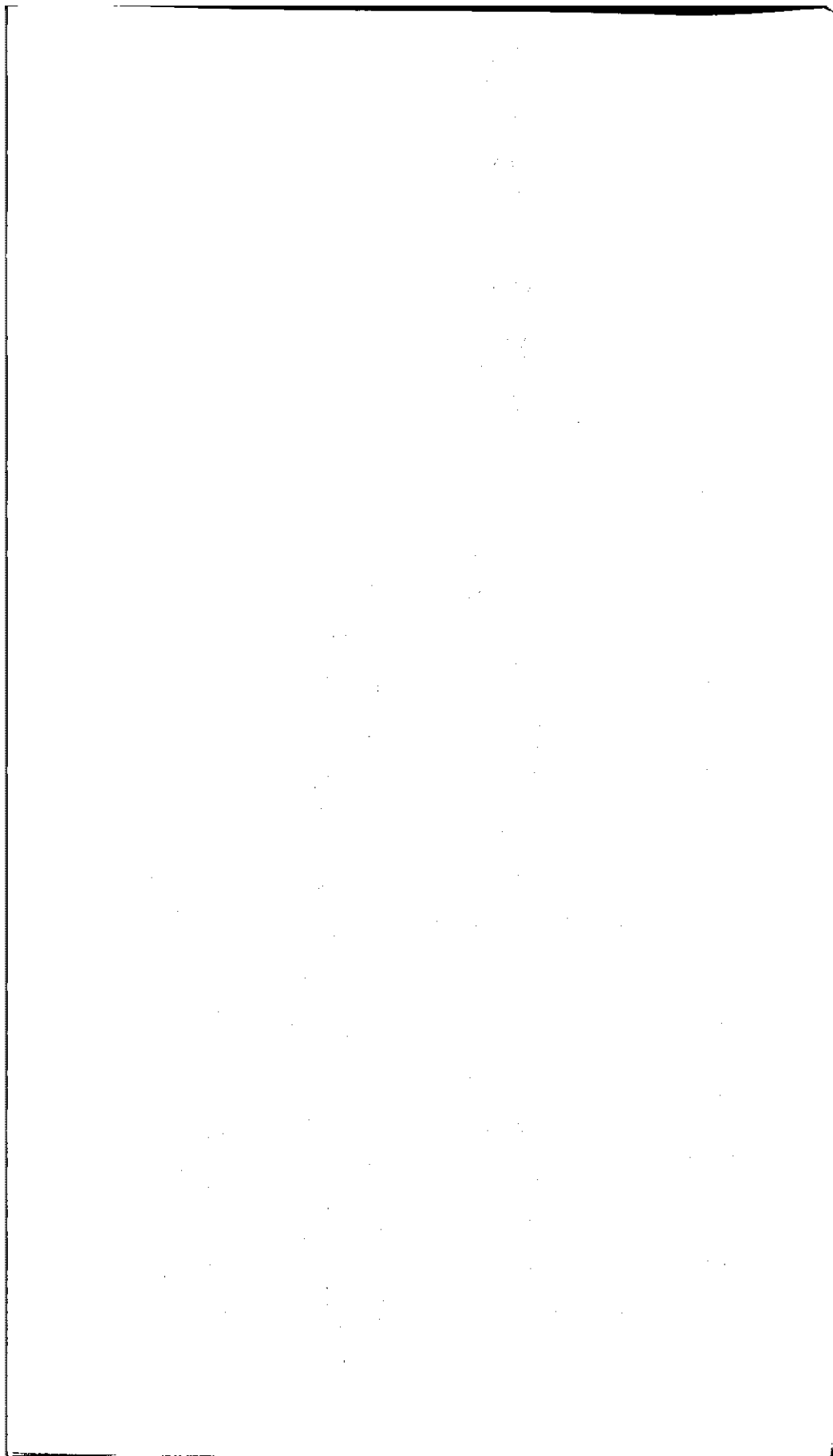
Round negotiations demonstrates that EU-US leadership could succeed in including such institutional reforms into the final package of Doha Round Agreements. Once the Doha Round Agreements have been agreed upon, it may last another decade before WTO Members may launch another round of negotiations on new WTO rules and institutional reforms. If the Doha Round negotiations fail, the economic and legal arguments for concluding a Transatlantic Free Trade Area (TAFTA) would remain strong. If the Doha Round negotiations succeeds in liberalizing agricultural trade and market access for goods and services, there may no longer be enough economic and political incentives for concluding a TAFTA. Yet, joint EU-US leadership for further reforms of the world trading system and WTO dispute settlement system should remain a priority of transatlantic policy-coordination. For example, many intergovernmental disputes in the WTO about private rights (e.g. regarding the trademark "Havana Club") could be de-politicized and de-centralized following the example of EC law where EC trade rules tend to be enforced by private traders in domestic courts and the EC Court rendered only two judgments on disputes among EC member states since the entry into force of the EC Treaty in 1958. The example of China's WTO membership also illustrates that the significance of the WTO requirements of rule of law and independent national courts goes far beyond economics. Just as the EC Treaty has turned out to be one of the most successful peace treaties, the WTO legal system contributes not only to economic welfare, but also to rule of law, transparent governance, protection of private rights and peaceful cooperation across frontiers.



Part II

Transatlantic Regulatory Cooperation

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Chapter 4

Competition Policy Cooperation and the Pursuit of Better Practices*

William E. Kovacic

I. Introduction

Progress toward greater cooperation in competition policy between the European Union (EU) and the United States (US) is a success story in the modern transatlantic relationship. Despite differences in philosophy, procedure, analytical technique, and, occasionally, substantive outcomes, the past decade has featured important enhancements in measures by public and non-governmental bodies in both jurisdictions to improve cooperation in the formulation of competition policy governing transatlantic commercial activity. Although EU and US efforts to build effective means for cooperation antedated the establishment of the New Transatlantic Agenda (NTA) in 1995, developments in the EU-US relationship over the past decade are generally consistent with the NTA's goals for regulatory cooperation. Not only have the EU and the US taken significant steps to strengthen their own relationship, their cooperation has provided important insights for building a framework of global and regional cooperation through multinational networks such as the International Competition Network (ICN) and the Organization for Economic Cooperation and Development (OECD).

* The views presented here are the author's alone and not necessarily those of the US Federal Trade Commission or any of its members. The author thanks the participants in the Fiesole workshop for many useful comments and suggestions.

This paper examines the status of efforts to realize the NTA's aims in the field of competition policy. Part II of the paper summarizes the NTA's objectives and their application to competition policy. Part III then identifies measures that the EU and US have taken to improve regulatory cooperation in competition policy, particularly in the years following workshops convened on the topic of NTA implementation at the University of Wisconsin and the European University Institute in 1999 and 2000, respectively.¹ This part also identifies substantive results that can be attributed to recent EU and US cooperation measures. Part IV identifies areas for improved cooperation and describes means that the EU and US can take to accomplish such improvements. The paper concludes with observations about basic decisions that face the EU and the US agencies as they decide how to allocate resources to the transatlantic dialogue and to other international initiatives.

II. The NTA Objectives and their Application to Competition Policy

The NTA seeks to improve the quality and reduce the cost of regulating transatlantic commerce by improving cooperation between the European Union and the United States. As Mark Pollack and Gregory Shaffer have characterized its approach,² the NTA seeks to strengthen EU/US regulatory coordination by enhancing:

- *Intergovernmental contacts* among the chiefs of government and other high level public officials (such as agency or department heads);
- *Transgovernmental contacts* on a day-to-day basis among lower level officials; and
- *Transnational contacts* among non-governmental institutions and individuals, including academics and the business community.

This process-oriented approach has a number of applications to transatlantic competition policy and supplies a mechanism by which the EU and US competition policy might move toward the common adoption of superior norms.³ Efforts to promote convergence between the EU and the US competition policy systems often urge the adoption of what often are called "best practices." Experience in other

1 These workshops yielded the papers collected in *Transatlantic Governance in the Global Economy* (Mark A. Pollack & Gregory C. Shaffer eds., 2001; hereinafter *Transatlantic Governance*).

2 See Mark A. Pollack & Gregory C. Shaffer, "Transatlantic Governance in Historical and Theoretical Perspective," in *Transatlantic Governance*, at 3, 5.

3 "Norms" are consensus views within a group about how members of the group ought to behave. For an application of the concept of norms to the development of competition policy, see William E. Kovacic, "The Modern Evolution of US Competition Policy Norms," 71 *Antitrust Law Journal* 377 (2003) (hereinafter *Norms*).

areas of public and private law suggests that convergence across jurisdictions in competition policy might take place in a three-step process: decentralized experimentation at the national or regional level, the identification of superior approaches, and the opting-in to superior approaches by individual jurisdictions.⁴

The experimentation inherent in the distribution of competition policy authority across jurisdictions supplies a useful means to test different substantive commands, analytical techniques, and procedures. When experience in one jurisdiction illuminates superior approaches, such methods ought to become focal points for possible emulation by others. Without a conscious process to identify and adopt superior ideas, decentralization cannot fulfil its promise as source of useful policy innovations. The NTA can be seen as a vehicle for accomplishing the second of the three steps mentioned above—the identification of superior norms—and encouraging EU and US policy makers to undertake the third step of opting in to such norms.

Before examining recent EU/US cooperative activities in this field, it is useful to identify what the competition policy community realistically might expect the pursuit of initiatives consistent with the NTA agenda to accomplish. Rather than speaking of the promotion of “best” practices, it might be more accurate and informative to say that the objective is the pursuit of “better” practices. The development of competition policy in any jurisdiction is a work in progress. This stems from the inherently dynamic nature of the discipline. Most competition laws, including the laws of the EU and the US, can be envisioned as consciously evolutionary systems that contemplate the adaptation of analytical concepts over time to reflect new learning.⁵ To speak of “best” practices may suggest the existence of fixed objectives that, once attained, mark the end of the task. Envisioning problems of substance or process as having well-defined, immutable solutions may neglect the imperfect state of our knowledge and obscure how competition authorities must work continuously to adapt to a fluid environment that features industrial dynamism, new transactional phenomena, and continuing change in collateral institutions vital to the implementation of competition policy.

Perceiving the proper role of EU and US competition agency officials to be the continuing pursuit of *better* practices can focus attention on the need for the continuing reassessment and improvement of competition policy institutions. As

4 This model of convergence is presented in Timothy J. Muris, “Competition Agencies in a Market-Based Global Economy” (Brussels, Belgium, July 23, 2002) (prepared remarks at the Annual Lecture of the European Foreign Affairs Review), available at <http://www.ftc.gov/speeches/muris/020723/brussels>.

5 On the evolutionary qualities of the US system, see William E. Kovacic & Carl Shapiro, “Antitrust Policy: A Century of Economic and Legal Thinking,” 14 *Journal of Economic Perspectives* 43 (2000).

suggested below, a commitment to accomplish the forms of cooperation embodied in the NTA can encourage the EU and the US to make the cycle of reassessment and refinement a core element of their operations. The inquiry anticipated by this routine process of evaluation should focus on at the adequacy of the existing legislative framework, the effectiveness of existing institutions for implementation, and the quality of substantive outcomes from previous litigation and non-litigation interventions.

III. EU and US Cooperation Initiatives and Substantive Results

A summary stocktaking of cooperation initiatives corresponding to the three-level NTA agenda intergovernmental, transgovernmental, and transnational contacts reveals considerable activity throughout the decade since the NTA's adoption and an intensification of activity in the past five years. It is difficult to link these developments to a conscious pursuit of NTA aims, for significant EU and US cooperation measures in competition law originated well before NTA.⁶ One could say that the intensification of cooperative activity since 1995 has been inspired as much as anything else by the highly visible disputes between the jurisdictions in the Boeing/McDonnell Douglas and General Electric/Honeywell mergers and the perceived need to explore ways to avoid similar policy disagreements in the future. Nonetheless, without treating NTA as the cause of policy adjustments in recent years, it is accurate to say that the progression of modern cooperation contacts in all three NTA dimensions have been consistent with the NTA proposals.

Intergovernmental contacts have continued at the highest levels of the European Commission's Competition Directorate (DG COMP) and the US Department of Justice (DOJ) and the US Federal Trade Commission (FTC). These have occurred in a variety of contexts that go beyond the regular, formal EU/US bilateral consultations. For example, the EC Commissioner for Competition, the DG Comp Director General, DOJ's Assistant Attorney General for Antitrust, and the FTC's Chairman played pivotal roles in the formation of the ICN in 2001 and have cooperated extensively in the design and implementation of the ICN's working plan. Contact among this high level EU and US officials is also commonplace at conferences and in discussions about specific policy matters. Measured either by the sheer volume of contacts or the breadth and depth of discussions, the *intergovernmental* level of discourse in competition policy is more robust today than at any period of the EU/US relationship.

6 See Youri Devuyt, "Transatlantic Competition Relations," in *Transatlantic Governance*, at 127 (hereinafter *Devuyt*) (describing pre-NTA origins of transatlantic cooperation on competition matters).

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A recent, important dimension of the intergovernmental relationship that goes beyond competition policy alone deserves special emphasis. In the past three years, the FTC has undertaken extensive discussions with DG COMP and DG SANCO to explore policy connections between competition policy and consumer protection policy. This has been identified as an increasingly important concern in matters such as health care and nutrition, where decisions taken on issues such as advertising have significant competition and consumer protection implications. What we are seeing is the beginning of a new framework of regulatory relationships that recognizes the interdependency of what may have been conceived of as largely independent policy regimes. At the same time the FTC has expanded cooperation with EU Member States, such as the United Kingdom, that, like the FTC, combine the competition and consumer protection portfolios in one agency and have expressed an interest in promoting the integration of policymaking between these two disciplines.

The same can be said for experience with *transgovernmental* contacts. In recent years, the EU and US competition authorities have expanded the work plan of the existing staff-level merger working group and have established a new working group dealing with antitrust/intellectual property issues. The frequency of staff-level meetings, by teleconference or face-to-face meetings, also has increased to address a variety of matters within and outside the context of the formal working groups. For DOJ and the DG COMP, there has been a noteworthy expansion of interaction as DG COMP has implemented its own variant of the DOJ's leniency program for the prosecution of supplier cartels. Regular staff-to-staff contacts also have increased dramatically in the context of joint work on ICN and OECD projects.

A similar intensification of activity can be documented for *transnational contacts*. Measured by the agenda of conferences and non-conference activities, the major professional legal societies—among them, the American Bar Association and the International Bar Association—have expanded the energy they devote to EU/US competition policy. Beyond activities sponsored by these bodies, there has been a noteworthy increase in the number of conferences and continuing legal education programs with a large transatlantic component that attract a substantial transnational audience of academics, practitioners, and governmental officials. The same can be said for trade associations, such as the International Chamber of Commerce (ICC), and academic bodies, including new institutions such as the Association of Competition Economics (ACE) based in Europe. Collectively, these non-governmental networks have played a crucial role in educating the academics, the business community, and the legal profession about the foundations of competition policy in both jurisdictions and about current policy developments. By engaging governmental policymakers and participants from non-governmental constituencies in formal public debate and informal discussion, these bodies help formulate a consensus about competition policy norms and provide a key source of relational

glue for the competition policy community. Their significance can be observed in the growing tendency of government-based networks, such as ICN and OECD, to include non-governmental parties in their work.

It is possible to trace a number of specific policy outcomes to the three levels of contacts (intergovernmental, transgovernmental, and transnational) sketched above. Though not a complete accounting, the following list includes noteworthy measures rooted in the expanded interaction between governmental and non-governmental parties across the two jurisdictions.

- Enhancements in formal EU/US protocols involving merger review, including the coordination of pre-merger inquiries in both jurisdictions.
- New EU guidelines on merger policy and intellectual property licensing that featured significant discussion with US competition authorities and non-governmental bodies (such as the internationally-oriented legal societies and business associations) and reflected, in a number of respects, contributions by the US agencies and by the non-governmental groups.
- Continuing augmentation and implementation of the EU leniency program in ways that reflected substantial consultation and interaction with DOJ's anti-cartel unit.
- Greater transparency in US practice for merger and non-merger matters, including emulation in a growing number of instances of the EU practice of providing explanations for a decision not to prosecute where the enforcement agency has undertaken a substantial investigation.
- The successful launch of a new multinational competition policy network (the ICN) and the healthy invigoration of the work plans of existing networks such as OECD.

These and other measures likely would not have occurred when they did or as extensively as they did without the deeper transatlantic integration fostered by the three-level contacts that the EU and US have undertaken in a manner that at least is consistent with the NTA, if not necessarily inspired by the NTA.

IV. A Suggested Agenda for the Future: Concepts and Means

The three-level framework of cooperation supplies a basis for additional work to improve the EU/US relationship in the field of competition policy. Discussed below are possible conceptual focal points for further cooperation and a description of the specific means that the EU and US competition policy communities might take to address these points.

A. Concepts

For all of the progress in cooperation achieved to date, there is considerable room for learning about basic forces that shape policy in the EU and US and therefore influence the transatlantic relationship. Discussions among governmental officials and within non-governmental networks tend to focus on specific enforcement developments (e.g., the resolution in the EU and the US of each jurisdiction's Microsoft cases) or matters of practical technique and not to ask basic questions about the origins and institutional foundations of the systems. The discussion below suggests that the agenda for discourse inevitably must expand to incorporate examination of these considerations if cooperation is to be enriched and common progress toward better practices is to be achieved.

1. Toward a Deeper Understanding of the Origins and Evolution of Both Systems

The many recurring discussions about transatlantic competition policy often rest upon a terribly incomplete awareness about how the EU and US systems originated and have evolved over time. An relatively small subset of the US competition policy community engaged in transatlantic issues is familiar with the distinctive path by which competition policy concepts developed within the EU member states and supplied the foundation for the EU competition policy regime itself.⁷ European specialists in competition policy likewise often display a fractured conception of the origins and evolution of the US system—a conception often derived from the works of US scholars whose grasp of the actual path of US policy evolution is itself infirm.⁸ An accurate sense of where the policies originated and how they have unfolded is essential to understanding the influences that have shaped modern results in specific cases. To move ahead, discourse at all three levels embodied in the NTA must look back for a richer understanding of competition policy history.

7 The pre-eminent account of this history is David J. Gerber, *Law and Competition in Twentieth Century Europe – Protecting Prometheus* (Oxford paperback edition: 2001).

8 For example, in his excellent essay in *Transatlantic Governance*, Yuri Devuyt observes: “During the Reagan administration, the Department of Justice and the FTC engaged in a historically low level of antitrust enforcement in line with Ronald Reagan’s economic philosophy opposing government intervention in the marketplace. Under the Bush and Clinton administrations, the federal agencies resumed stricter enforcement of the antitrust laws.” *Devuyt*, at 128. Devuyt seems to have based this observation on the work of American scholars who endorse the “pendulum” interpretation of US antitrust history that likens changes in US policy to wild swings from excessive intervention in the 1960s and 1970s to inadequate intervention in the 1980s, followed by a sensible equilibrium in the 1990s. I have argued elsewhere that this is both an inaccurate and, for purposes of future policy development, a seriously flawed understanding of US experience. *See Kovacic, Norms*.

2. *Scrutinizing the Analytical and Policy Assumptions in Specific Cases*

The modern EU/US relationship has featured important instances of disagreement and will do so again in the future. Amid the many discussions of cases such as Boeing/McDonnell Douglas, GE/Honeywell, and Microsoft, two things seem to have received inadequate attention. The first, which only the competition agencies can perform, is a careful, confidential examination of the specific theories of intervention and an examination of the evidence upon which each jurisdiction relied in deciding how to proceed. The side-by-side, behind-closed-doors deconstruction of the decision to prosecute (or not to prosecute) would seem to be a valuable way to identify alternative interpretations and test them in an uninhibited debate involving agency insiders (and, perhaps, experts retained by each agency to assist in the review of the case). Yet discussions of this type generally do not take place.

Even more general discussions of cases that occupy considerable attention at conferences and seminars infrequently come to grips with what appear to be differences in assumptions about the operation of markets and the efficacy of governmental intervention as a tool to correct market failure. Embedded in EU and US agency evaluations of the highly visible matters mentioned earlier are differing assumptions about the adroitness of rivals and purchasers to reposition themselves in the face of exclusionary conduct by a dominant rival, the appropriate tradeoff between short-term benefits of a challenged practice and long-term effects, and the robustness of future entry as a means for disciplining firms that presently enjoy dominance. Putting these and other critical assumptions front and centre in the discussion, along with the bases for the assumptions, would advance the transatlantic in the future.

3. *Focusing on How Institutional Design Affects Doctrine*

In discussing competition law, there is a tendency for academics, enforcement officials, and practitioners to focus on developments in doctrine and policy and to assign secondary significance to the institutional arrangements by which doctrine and policy take shape. This tendency can cause one to overlook the important role that the design of institutions can play in influencing substantive results. It is impossible to understand the development of EU and US competition law without considering the impact of:

- Private rights of action and mandatory treble damage liability in shaping the views of US courts and enforcement agencies about the appropriate boundaries of substantive doctrine concerning antitrust liability.
- The experience gained by European competition authorities in carrying out responsibilities for policing excessive pricing as an abuse of dominance in informing their views about the wisdom and administrability of measures that mandate access to specific assets.

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- The nature and timing of judicial oversight in merger control.
- The internal organization of competition agencies, including the placement of economists within the agency organization chart and the procedure for their participation in the decision to prosecute.
- The decision to accept a revolving door in recruitment—the manner in which the competition agency recruits professional personnel and the backgrounds of the agency's professionals who work for the agencies and the parties who appear before the agencies.

Consider the possible impact of creating robust private rights of action in the American style—with mandatory treble damages, with relatively permissive standards for the aggregation of class claims, and asymmetric fee-shifting in which only a prevailing plaintiff recovers its fees.⁹ In establishing this variant of a private right of action, the jurisdiction must keep in mind the possible interaction between the operation of private rights of action and public law enforcement. If courts fear that the private party incentives to sue are misaligned with the larger interests of the public (put another way, when the courts do not trust the private plaintiff as much as they trust a public prosecutor) or they fear that the remedial scheme (e.g., mandatory treble damages for all offences) deters legitimate business conduct excessively, the courts will use measures within their control to correct the perceived imbalance. The courts may “equilibrate” the antitrust system by constructing doctrinal tests under the rubric of “standing” or “injury” that make it harder for the private party to pursue its case; adjust evidentiary requirements that must be satisfied to prove violations; or alter substantive liability rules in ways that make it more difficult for the plaintiff to establish the defendant's liability.

The first of these methods only governs suits by private plaintiffs. Of particular significance to public enforcement authorities is the possibility that the courts, in using the second and third measures listed above, will endorse principles that apply to the resolution of all antitrust disputes, regardless of the plaintiff's identity. In the course of making adjustments in evidentiary tests or substantive standards to correct for perceived infirmities in private rights of action, courts may create rules of general applicability that encumber public prosecutors as much as private litigants.

This hypothesis may help explain the modern evolution of US antitrust doctrine. Since the mid-1970s, the US courts have established relatively demanding standards that private plaintiffs must satisfy to demonstrate that they have standing to press antitrust claims and have suffered “antitrust injury.”¹⁰ In this period, the courts have

9 The discussion here is based in part on William E. Kovacic, “Public Participation in the Enforcement of Public Competition Laws,” in *Current Competition Law Volume II*, at 167 (Mads Andenas et al. eds., 2004).

10 These requirements are described in ABA Section of Antitrust Law, *Antitrust Fundamentals* 838-69 (5th Edition 2003).

endorsed evidentiary tests that make it more difficult for plaintiffs to prove concerted action involving allegations of unlawful horizontal and vertical contractual restraints. With some variation, courts also have given dominant firms comparatively greater freedom to choose pricing and product development strategies.

Collectively, these developments have narrowed the scope of the US antitrust system. Most of the critical judicial decisions in this evolution of doctrine have involved private plaintiffs pressing treble damage claims. Perhaps the most interesting area to consider the possible interaction between the private right of action and the development of doctrine involves the fields of monopolization and attempted monopolization law. Litigation involving exclusionary conduct by IBM provides a useful illustration.¹¹ In the late 1960s, the Department of Justice initiated an abuse of dominance case that sought, among other ends, to break IBM up into several new companies. By 1975, roughly 45 private suits had been filed against IBM alleging unlawful exclusionary conduct and seeking treble damages against IBM. The sum of all damage claims in the private cases exceeded \$4 billion—a considerable amount at the time.

My intuition is that courts reacted to the private cases with apprehension and were ill at ease with the possibility that a finding of illegal monopolization would trigger the imposition of massive damage awards against IBM. The courts in these matters could not refuse to treble damages if they found liability, but they could interpret the law in ways that resulted in a finding of no liability. IBM paid settlements to a small number of the private claimants, but it achieved vindication in most of the private cases. The results in the private damage cases against IBM and several other leading US industrial firms in this period imbued US monopolization doctrine with analytical approaches and conceptual perspectives that viewed intervention sceptically.¹²

My hypothesis about the American competition policy experience is that US antitrust doctrine would have taken a somewhat different path had there been no private rights of action, or if the damage remedy in private actions had been less potent—for example, limiting recovery to actual damages, or permitting trebling only for violations of *per se* offences such as horizontal price-fixing. Specifically, US antitrust doctrine would have assumed a more intervention-oriented character if

11 For a discussion of the government and private suits against IBM in the late 1960s and in the 1970s, see William E. Kovacic, *Designing Antitrust Remedies for Dominant Firm Misconduct*, 31 Connecticut Law Review 1285, 1289-90 (1999).

12 As a further point of reference, I find it significant that the context for the US Supreme Court's *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 124 S. Ct. 872 (2004) was a private class action lawsuit. The defendant telecommunications companies warned of incurring billions upon billions of dollars of potential liability if the Court were to vindicate the plaintiff's theory of liability.

the power to enforce the American competition statutes were vested exclusively in public enforcement authorities, or if the private right of action had been circumscribed in one or more of the ways indicated above.

This raises the question of what will happen in the EU and its Member States if private rights of action grow more robust. My tentative prediction is that an expansion of private rights could lead judicial tribunals to adjust doctrine in ways that shrink the zone of liability. For example, an expansion in private rights of action could cause EU abuse of dominance doctrine to converge more closely upon US liability standards governing monopolization.

4. Devoting Attention to Inter- and Intra-jurisdictional Multiplicity and Interdependency

Efforts to formulate effective competition policy increasingly will require EU and US competition agencies to study more closely how other governmental institutions affect the competitive process. To an important degree, both jurisdictions resemble a policymaking archipelago in which various governmental bodies other than the competition agency deeply influence the state of competition.¹³ Too often each policy island in the archipelago acts in relative isolation, with a terribly incomplete awareness of how its behaviour affects the entire archipelago. It is ever more apparent that competition agencies must use non-litigation policy instruments to build the intellectual and policy infrastructure that connects the islands and engenders a government-wide ethic that promotes competition.

To build this infrastructure requires competition authorities to make efforts to identify and understand the relevant interdependencies and to build relationships with other public instrumentalities. This is particularly evident in the relationship between competition policy and intellectual property.¹⁴ Better coordination could limit inconsistencies between the two systems and ensure that both can more effectively encourage innovation and competition. While cooperation and convergence activities involving competition policy and intellectual property policy have grown more intense in recent years, to date they have tended to be intra-disciplinary. Few cooperation and convergence activities account for the interdependency of the competition policy and intellectual property regimes.

13 The dimensions and consequences of policymaking fragmentation within individual jurisdictions are analyzed in Andrew I. Gavil, William E. Kovacic & Jonathan B. Baker, *Antitrust Law in Perspective: Cases, Concepts and Problems in Competition Policy* (2002). See also William E. Kovacic, "Toward a Domestic Competition Network," in *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* 316 (Richard A. Epstein & Michael S. Greve eds., 2004) (describing fragmentation of policymaking affecting competition in US).

14 See William E. Kovacic & Andreas Reindl, "An Interdisciplinary Approach to Improving Competition Policy and Intellectual Policy" (April 2004).

Members of the EU and US competition policy community could use several means to address the conceptual issues outlined above. Most means involve a reorientation of bilateral activity to invest more expansively in a knowledge base that would inform routine discussions at all three levels of the NTA framework. Possible specific techniques are summarized below.

5. *Periodic Comprehensive Reviews of Institutional Arrangements*

Both jurisdictions at regular intervals should undertake a basic evaluation of the effectiveness of their competition policy institutions. In many respects, the EU stands far ahead of the US in carrying out this type of assessment. The major institutional reforms introduced in the past year—modernization, reorganization of DG Comp, and the introduction of a new position of economic advisor—indicate the EU's close attention to these issues.

Key focal points for a parallel inquiry in the US ought to include the scope of coverage of the competition policy system, the adequacy of existing substantive rules and remedies, the type and consequences of public enforcement, the role of private rights of action, and the design and administration of public enforcement bodies. Such an assessment ought to involve participation of governmental officials, private parties, consumer groups, and academics. Given the continuing changes that confront competition agencies, the two systems should undertake this comprehensive assessment less than once per decade.

6. *Ex Post Evaluation*

The EU and the US routinely should evaluate its past policy interventions and the quality of its administrative processes.¹⁵ In every budget cycle, each authority should allocate some resources to the ex post study of law enforcement and advocacy outcomes. Beyond studying what it has achieved, a competition authority should choose selected elements of its enforcement process and methodology for assessment. Rather than treating ex post evaluation as a purely optional, luxury component of policy making, we must regard the analysis of past outcomes and practices as a natural and necessary element of responsible public administration. Even if definitive measurements are unattainable, there is considerable room for progress in determining whether actual experience bears out the assumptions that guide our acts. One element of the process of examining past decisions would be the type of detailed case study mentioned earlier in this paper. An elaborate deconstruction of specific cases would provide an informative basis for analyzing

15 The potential contributions of ex post analysis of completed government interventions to the development of competition policy are examined in William E. Kovacic, "Evaluating Antitrust Experiments: Using Ex Post Assessments of Government Enforcement Decisions to Inform Competition Policy," 9 *George Mason Law Review* 843 (2001).

differences in philosophy and substantive perspective and for identifying variations in procedure.¹⁶

7. *Enhancement and Disclosure of Data Bases*

The EU and the US should prepare and provide a full statistical profile of their enforcement activity. The maintenance and public disclosure of comprehensive, informative data bases on enforcement are distressingly uncommon in our field. Every authority should take the seemingly pedestrian but often neglected step of developing and making publicly available a data base that (a) reports each case initiated; (b) provides the subsequent procedural and decisional history of the case; and c) assembles aggregate statistics each year by type of case. Each agency should develop and apply a classification scheme that permits its own staff and external observers to see how many matters of a given type the agency has initiated and to know the identity of specific matters included in category of enforcement activity. Among other ends, a current and historically complete enforcement data base would promote better understanding and analysis, inside and outside the agency, of trends in enforcement activity.¹⁷ For example, access to such data bases would give competition agencies greater ability to benchmark their operations with their peers.

8. *Assessment and Enhancement of Human Capital*

Continuous institutional improvement will require the EU and US competition agencies to regularly evaluate their human capital. The capacity of an agency's staff deeply influences what it can accomplish. The agencies routinely must examine the fit between their activities and the expertise of their professionals. The agencies could share views about developing a systematic training regimen for upgrading the skills of their professionals. For example, where the agencies are active in areas such as intellectual property that require special expertise, the agencies could explore whether they have acquired the requisite specialized skills—for example, by hiring some patent attorneys. The experiences of the agencies with entry and lateral recruitment—including the costs and benefits of the revolving door—would be useful focal points for discussion. A fuller program of staff exchanges also might supply an effective means for improving the discussion at the staff level and educating each agency about how the other builds capability.

16 For a suggestion of the content of such a case study, see William E. Kovacic, "Transatlantic Turbulence: The Boeing-McDonnell Douglas Merger and International Competition Policy," 68 *Antitrust Law Journal* 805 (2001).

17 For a formative treatment of the value of good statistical records for the analysis of competition policy, see Richard A. Posner, "A Statistical Study of Antitrust Enforcement," 13 *Journal of Law & Economics* 365 (1970).

9. *Investments in Competition Policy R&D and Policy Planning*

An essential element of continuous institutional improvement is the enhancement of the competition agency's knowledge base. In many activities, particularly in conducting advocacy, the effectiveness of competition agencies depends on establishing intellectual leadership. To generate good ideas and demonstrate the empirical soundness of specific policy recommendations, competition authorities must invest resources in what FTC Chairman Timothy Muris has called "competition policy research and development."¹⁸ Regular outlays for research and analysis serve to address the recurring criticism that competition policy lags unacceptably in understanding the commercial phenomena it seeks to address.

Examining the R&D function is one element of exploring larger questions about how the competition agencies should set priorities and, within the larger competition policy community, about what competition agencies should do. The question of setting priorities is likely to assume greater importance in the EU as certain functions that once occupied considerable EU attention devolve to the Member States, freeing resources for the DG Comp to design new programs. The consideration of how we measure agency performance, and assess the mix of its activities, is a topic for a larger discussion within the competition community. For example, on the scorecard by which we measure competition agencies, there is continuing awareness that we should count the suppression of harmful public intervention just as heavily as the prosecution of a case that forestalls a private restraint.¹⁹

V. **Conclusion: Future International Relationships**

The *best* practice in competition policy is the relentless pursuit of *better* practices. The EU/US relationship in competition policy has reflected this principal in a manner consistent with the aims of the NTA. A basic implication of past work and the future program I have suggested here is that the competition authorities (and non-governmental bodies) must be willing to invest significant resources in the development and maintenance of the relationships as a dedicated objective even though such investments do not immediately generate the outputs—most notably,

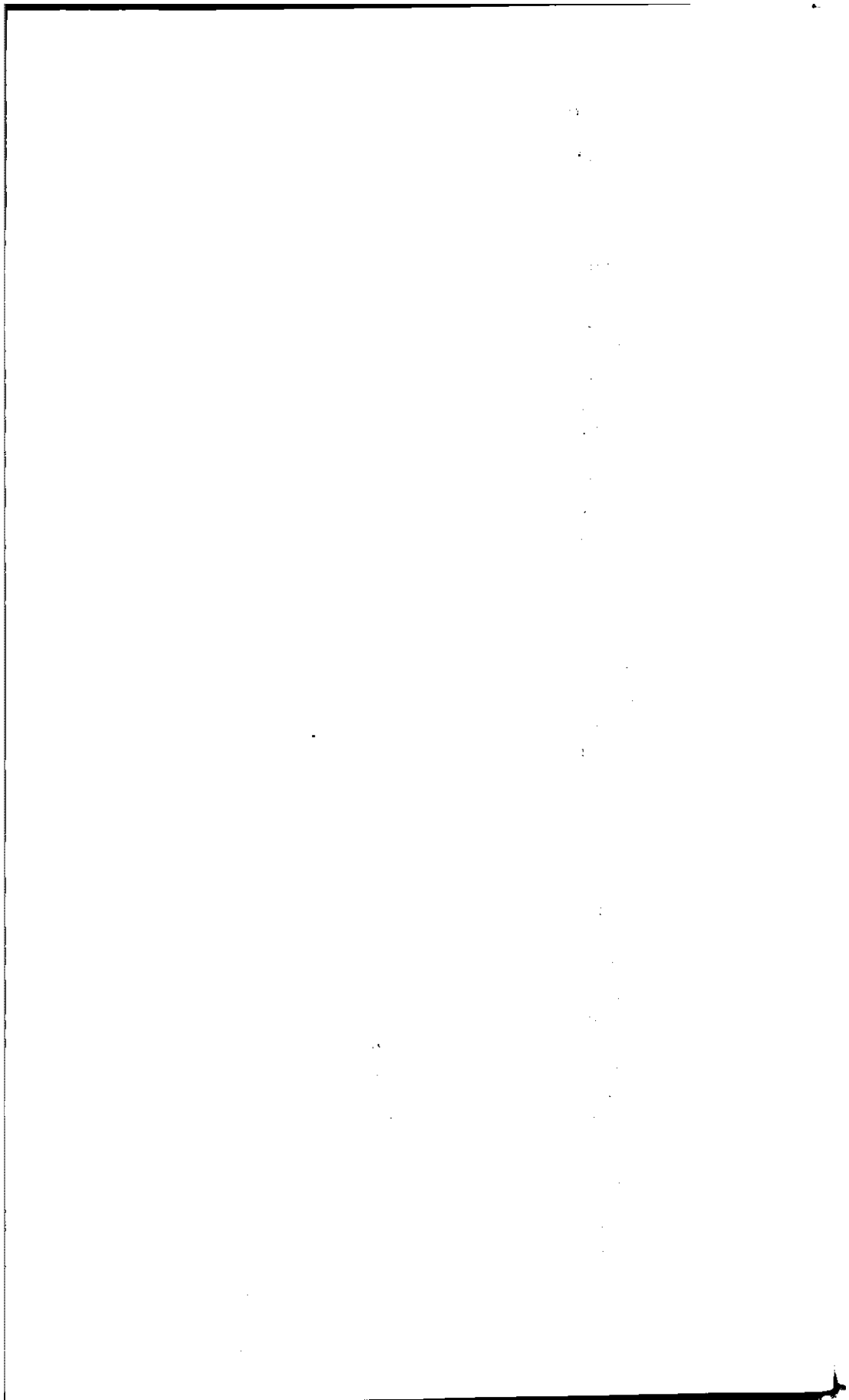
18 The concept of "competition policy research and development" and its role in determining institutional capability are analyzed in Timothy J. Muris, "Looking Forward: The Federal Trade Commission and the Future Development of US Competition Policy," 2003 Columbia Business Law Review 359.

19 Competition agencies must confront government restrictions on competition with the same commitment and determination with which they challenge private restraints. See Timothy J. Muris, "State Intervention/State Action – A US Perspective" (New York, N.Y., Oct. 24, 2003) (remarks before the Fordham Annual Conference in International Antitrust Law & Policy), available at <http://www.ftc.gov/speeches/muris/fordham031024.pdf>.

cases—by which competition authorities traditionally are measured. The success of the relationships requires investments in the type of overhead and network building that commentators, practitioners, and, perhaps, legislative appropriations bodies often view with some scepticism. Thus, one challenge is for the competition authorities to develop acceptance of a norm that regards these investments as valuable and necessary.

Competition agencies also must confront the question of how many resources, even in the best of circumstances, they can devote to the construction and maintenance of networks that provide the framework for international relations in this field. The EU and the US are engaged not only in their own bilateral arrangements, but also bilateral agreements with other jurisdictions, participation in regional initiatives, and work in multinational networks such as ICN, OECD, and the competition policy working group of the World Trade Organization. The EU and US are major partners in all of these overlapping ventures, and each year each agency must decide, through its commitment of personnel, to “buy,” “sell,” or “hold” its position in each venture. Each agency is aware that the participation in these activities cannot be carried out effectively—namely, with good substantive results—except through the allocation of first-rate personnel. There is no point in trying to do this work on the cheap.

The hazard is that the EU, the US, and other jurisdictions may experience, or may now be encountering, some measure of international network or relationship fatigue. Thus, a further focus for consideration by the two jurisdictions, individually and jointly, is how best to devote their resources. In this decision, both agencies are likely to regard the transatlantic relationship as a top priority. This is true because of the importance of the relationship to the regulation of transatlantic commerce and because the EU and the US always will have distinctive interests and common issues owing to their comparatively larger base of experience. Moreover, the EU/US relationship has served, in effect, as a bilateral test bed for substantive concepts and processes that can be rolled out in a larger multinational setting. Experience within the bilateral relationship has usefully informed EU and US decisions about what might be accomplished in the larger spheres. As the EU and the US approach perceived limits on how much they can dedicate to this growing collection of international initiatives, the larger competition policy community will need to abandon a case-centric vision of what agencies should do and accept the need for institution building, at home and abroad, as a vital ingredient of sound competition policy for the future.



Chapter 5

Transatlantic Economic Governance: The Domains and Dimensions of Competition Law

David J. Gerber

I. Introduction

In June, 2001, the European Commission prohibited a merger between two very large US Corporations, General Electric and Honeywell, which would have been one of the largest corporate mergers in history. The merger had previously been approved by the US Department of Justice, and few thought that the Commission would dare to prohibit it. When it did, the result was widely-publicized outrage from many in government and business circles in the United States. The Commission's response was, in essence, we are just applying our law, and we have every right to do so.

This type of altercation was not supposed to happen. Since the early 1990s, transatlantic regulatory interaction had been increasingly discussed in network-based terms,¹ and mechanisms of cooperation between antitrust authorities in the US and the EU had been developing since the mid-1990s.² As a consequence, many

1 For discussions of this relationship, see Mark A. Pollack and Gregory C. Shaffer, *Transatlantic Governance in the Global Economy* (2001) and George A. Bermann et al., *Transatlantic Regulatory Cooperation: Legal Problems and Policy Prospects* (2000).

2 For discussion of some of these mechanisms, see, e.g., David J. Gerber, *The European-US Conflict over the Globalization of Antitrust Law*, 34 *New England L. Rev.* (1999).

were surprised that these cooperative relationships not only were unable to prevent the conflict, but also seemed to play no role in discussions of the events. These cooperative mechanisms had been widely viewed as a new form of governance that was more appropriate for a globalizing world than the traditional state-centred forms of law,³ and many believed that this form of governance would largely eliminate such conflicts or at least minimize the damage they caused.

As a result, the transatlantic governance relationship presented a murky and ambiguous picture. It intertwined and intermingled two quite different images of the relationship, and they often seemed to conflict. One was the rosy image of cooperation of well-intentioned regulators moving toward ever more harmonious governance on the basis of common interests. Here power and national interests seemed to play little, if any, role. The other image was darker. In it, national power and traditional forms of national interests seemed to be the key elements in the relationship. The indistinct intertwining of these images clouded interpretations of the events. These two images also hint at the central theme of this essay.

The uncertainty about the transatlantic governance relationship that the GE/Honeywell conflict created was not limited to competition law, but often extended to the relationship generally. Competition law was an area that seemed to many to be particularly suited to cooperative initiatives. Moreover, progress in developing such initiatives in the area had been rapid. Discussions of a new era of transnational regulatory cooperation had provided an alternative way of looking at the relationship, but it now seemed to bring confusion rather than analytical clarity. The conflict thus foregrounded a fundamental question: how should transatlantic regulatory issues be analyzed? Network theory had flagged the issue, but it had yet to provide a full range of conceptual tools for analyzing it.

This essay sketches some tools that may be of value in analyzing the transatlantic governance relationship. It then demonstrates the potential utility of these tools by applying them to the GE/Honeywell conflict. Finally, it draws some implications from this analysis and makes some modest suggestions for improving transatlantic economic governance.

I examine four claims about transatlantic economic governance. The first and most basic is that we can usefully identify two separate domains or dimensions of the relationship. One is the domain of the network, whose central principle is cooperation. The other is the domain of law, where difference and conflict typically shape decisions. The two domains operate according to different logics and are informed by different experiences. A second claim is that the relationship between

3 For a recent and extensive discussion of the network governance issue, see Anne-Marie Slaughter, *A New World Order* (2004). See also Kal Raustiala, *The Architecture of International Cooperation: Transgovernmental Networks and the Future of International Law*, 43 *Virginia L. Rev.* 1 (2002).

these two domains plays important roles in shaping the dynamics of transatlantic economic governance. Third, the essay claims that national laws and legal cultures shape each domain as well as the interactions between the two domains. They enable cooperation, but they also limit it, and they shape and fuel conflicts. The fourth claim is that effective analysis of transatlantic economic governance requires a multidimensional lens in which networks, law, private and public interests and the imaging of each are interrelated.

Note that I here use the term "economic governance" to refer to the exercise of normative influence on economic conduct, regardless of the specific structure or origin of that influence. The term is often used today to designate only those normative influences that are associated with regulatory networks. In this usage, it is often seen as an alternative form of normative influence that is the opposite of traditional legal operations and barely, if at all, related to them. In my view, this tends to distort analysis by severing the conceptual link between the two. Both regulatory networks and traditional legal institutions exercise normative influence on decisions, and it is their relationship in doing so that is critical to understanding those decisions.

II. The Domains of Competition Law Governance

The concept "domain" is central to the analysis. I use it to refer to a distinct component of a governance relationship that influences in systematic ways a defined set of decisions within the relationship.⁴ At least three conditions must be met in order to identify such a domain. First, it must include an identifiable group of participants. Second, these participants must address each other and respond to each other regarding the relevant set of decisions. Third, they must share a common set of reference points in referring and responding to each other. These may include, e.g., a shared image of the relationship, shared assumptions and shared experiences. In identifying a domain it is necessary to specify the set of decisions to which the domain refers. For purposes of this essay, those issues relate to the application of competition law norms.

A. Cooperation: The Domain of the Network

One domain of the transatlantic competition law relationship can be identified in the network of regulatory officials from the US and Europe who are involved directly or indirectly with the application of competition law in transatlantic contexts. These officials often talk with each other about existing or possible violations of

⁴ The terms "dimension" and "mode" could also be used for this purpose, but the term "domain" more effectively captures the image of a distinct set of influences on a specified set of decisions.

competition law, the problems of identifying anticompetitive conduct and similar regulatory issues.

The participants are few in number and have often met with each other personally (sometimes often). They share the same basic set of objectives—i.e., to more effectively apply competition law in situations which extend beyond national or other jurisdictional borders. It is, therefore, a cooperative relationship in which the participants have significant incentives to work together and few incentives to oppose each other.

Interactions between members of the group are not widely known outside the group, and thus group members seldom have incentives in interacting with each other to take into consideration the views and/or interests of group outsiders. Moreover, although they represent their governments and the administrative offices in which they are employed, they have little incentive in interacting with each other to consider goals other than the cooperative goals that they share with others in the group.

The set of decisions to which this domain refers is limited, and this conditions the internal dynamics of the domain. In general, the interactions among the members of this group consist in supplying each other with information. The extent to which they are authorized to exchange information is determined by bilateral agreements between the EU and the US.⁵ In general, the range of information that can be exchanged consists of two types: (1) general information about markets and market conditions and (2) specific information acquired pursuant to the investigation of potential competition law infractions. The latter category is further limited by the requirement that specific information acquired pursuant to an investigation can generally be exchanged only where the party involved approves the exchange. This limited sphere of operation is a major factor in shaping the incentive structures within the group.

This shared experience is the central point of reference for all members of the group. In addition, it is the basis for a shared image of transatlantic economic governance. In it, the EU-US relationship is portrayed as essentially cooperative. Officials share the same basic interests and objectives. It is important to note that this shared image refers to process rather than output. Moreover, it does not generally include claims about specific levels or forms of effectiveness. In this context, misperceptions and misunderstandings that occur between group members can be readily and unobtrusively corrected, precisely because intra-group communications are generally not public.

5 These agreements provide other limited forms of interaction. For example, the so-called "positive comity" concept permits one government (A) to request that another (B) take specified enforcement actions under B law. The requested state is not under an obligation to adhere to the request, and these interactions appear to play a minor role in network operations.

The image is private in the sense that the conduct to which it relates is not public. It is generally held and propagated either by group members or by outsiders who view and propagate it in relatively abstract and sometimes idealistic terms. This means that external interests do not easily attach to the propagation of the image. Few are in a position to promote the image, but, conversely, there are also few incentives to contest it.

B. The Domain of Law⁶

A second domain of the transatlantic economic governance relationship represents a sharp contrast. Here the relationship is conceived in terms of law. It consists primarily of two systems of norms and institutions that come into contact with each other at specific points. The interactions are formal and juridical. They are also often political, with national interests and power positions playing the central roles in particular encounters.

This domain is more inclusive in terms of participation and generally broader and more poorly defined than the network domain. All who are involved in or who seek to influence national competition law decisions with transnational implications are included. States are central actors, because they make and enforce laws, and because their interests are often closely tied to the reach and effectiveness of those laws. Also included, however, are sub-state actors who view those laws and their implementation through the lens of their own interests. Businesses who may benefit or lose from competition law decisions generally participate in the domain, as do lawyers, accountants and others who represent or seek to represent those businesses. The experience that provides a common reference point here is the experience of national laws and legal systems. Each participant has experienced the operations of her own national legal system, typically her own national competition laws, and thus that experience of national law tends to become the reference point for thought and discussion of transatlantic governance relationships. From this perspective, for example, a central issue is how to enforce legal provisions—how the state can increase compliance with its wishes.

Participants in this domain share an image of the transatlantic economic governance relationship that centres on contact between the components of legal systems (principally, norms and institutions). This conception of the relationship is inherently conflictual, because each system has its own rules and procedures, and thus points of interaction are perceived as the locus of loss or gain. As a result, each point of contact and difference represents a potential point of conflict.

6 Use of the word "law" to describe this domain is not optimal, because the term is used in a variety of ways. I use it here because it focuses attention on the distinguishing analytical characteristic of this domain B, i.e., the centrality of legal language, institutions, and experience in its operations.

In this context, each system also symbolically represents an extension of the state as a political entity. Power thus becomes a defining feature in viewing the interaction of the US and EU systems. To enforce effectively one's own laws is to assert effectively the power of the state that the laws represent. Where there is a conflict of state interests, a state's effectiveness vis-à-vis the other state is seen as an issue of winning or losing. In this light, to give ground is seen as a sign of weakness.

This domain involves several levels of interaction. At the state level, the relationship is formal: rights and obligations produced by agreements between governments. In this formal context, governments have no common goals other than those embodied in formal agreements, and in the competition law context these are typically limited to general statements about the need to cooperate. Governments provide domestic legal mechanisms to effectuate political goals, and they have no obligation to avoid conflicts or to aid each other, except to the limited extent provided in the relevant agreements.

At the sub-state level, the respective sets of domestic actors (US and European) pursue their own interests by seeking to influence political and legal decisions. In specific cases, these domestic interests typically have little incentive to push governments to cooperate and significant incentives to use domestic institutions to further their own private ends. For example, firms tend to prefer the advantages of being subject to their own laws, because they are more likely to be in a position to both ascertain the operative rules and to influence the decisions of those making and enforcing the rules.

Participants in this domain often respond to each other in public. They make claims and counterclaims in the public media. Given that the group is large and non-exclusive, and given further that the participants do not perceive a common goal, there are often incentives to make claims based exclusively on domestic political appeal. Here the incentives to promote cooperation are limited, especially where that cooperation takes place within a group of administrators whose actions are generally not observable by outsiders and from which private parties are generally excluded.

Differences in law and legal culture shape the dynamics of these interactions. Points of differences are also points of potential conflict. They tend to create rigidities and to represent fixed positions. Where, as here, interactions are public, external interests readily attach to any such position. Moreover, in this context, simple misunderstandings (e.g., about the meaning of concepts or the function of institutions or the rights and responsibilities of public decision makers) often unnecessarily and mistakenly become points of conflict, simply because there is no mechanism for easily and unobtrusively explaining the differences or negotiating the elements of misunderstanding.

The two domains thus provide sharp contrasts. In one, the relationship is based on shared personal experiences and operates on a largely cooperative logic. In the other, the relationship is conceived as an encounter between legal systems and is driven largely by national interests.

III. Relating the Domains

Identifying and analyzing these two domains has an additional benefit. It makes possible an analysis of the relationship between the two. This turns out to provide potentially valuable insights into transatlantic economic governance. The question here then is how the two domains influence each other—i.e., how they interact in influencing decisions.

Looking first at direct influences, we note that the two domains influence each other, but that the relationship is asymmetrical. Law's domain directly shapes the operations of the network, but the network has little influence on the operations of the legal domain. The legal domain controls the very existence of the network, because it provides authority for network participants to share information. This means, of course, that it also limits the scope of operations of the network by limiting the authorized conduct of its members. In contrast, the network has limited capacity to provide incentives or disincentives for decisions within the legal domain.

Indirect influences exhibit a similar asymmetry. Participants in each domain have incentives to sell their version of the relationship. Network participants gain status by emphasizing the importance and the potential of a cooperative vision of the relationship. Lawyers, politicians and businesses tend to benefit from emphasizing the dominant role of law (and their capacity to influence it). Given, however, that the latter is a public image and the former is generally known only to network insiders, the law-based image is more widely known than is the network image.

IV. The GE-Honeywell Merger: Law-Network Interactions

The GE-Honeywell case demonstrates the potential value of using the analytical framework sketched above. I do not suggest that it represents proof of any claim. I use it only to demonstrate how the analysis might be applied.⁷

⁷ I have previously used the GE-Honeywell example and some of the material here for purposes of a different kind of analysis. See David J. Gerber, *The European Commission's GE/Honeywell Decision: US Responses and Their Implications*, 1 *Journal of Competition Law* 87 (2003).

Our concern here is not with the legal issues in the respective decisions of the respective EU and US regulatory authorities. The focus here is on the governance relationship in which those decisions were imbedded and on their significance for assessing that relationship.⁸

The planned merger between GE and Honeywell was widely and prominently reported in the US press in early 2001. It was to be an extraordinary event, perhaps the largest merger in history. According to most reports, the only question as to whether it would be consummated was whether the US antitrust authorities would approve it. Few noted the possibility that the EU competition authorities would prohibit the merger. When the US authorities approved the merger, most assumed that the merger would take place. Many were shocked, therefore, when shortly thereafter the EU commission disapproved the merger, despite both private and public appeals from high-ranking US officials. This led to abandonment of the merger and widespread condemnation of the Commission decision in the US media as well as in US political circles. It also led to a wave of doubts about the future of EU-US relations.

When we apply a domain-based lens to the developments, however, the structure of the conflict and the dynamics of decision making become clearer. Each domain functioned within its own sphere and according to its own logic, and they related to each other in predictable ways. We look first at the two domains and then at their relationship.

A. The Marginal Role of the Network

The network of regulatory officials did what it was supposed to do, and operated as it could have been expected to operate. Officials discussed the issues, identified differences in positions and provided information to each other. These are the operations it is authorized to perform. In the end, these interactions did not avoid the conflict or otherwise apparently influence its development. This does not, however, mean that they were meaningless. For example, by disseminating information and improving awareness of existing legal differences within the network they laid the groundwork for more intensive exchanges both within and outside the network after the conflict subsided. If the network did not fulfil the expectations of many, the problem lay primarily in the expectations and in lack of awareness of the two distinct domains of operation within the governance relationship.

⁸ For detailed analysis of the Boeing-McDonnell Douglas merger case, which played a significant role in setting the background for the GE-Honeywell case, see William E. Kovacic, *Transatlantic Turbulence: The Boeing-McDonnell Douglas Merger and International Competition Policy*, 68 *Antitrust L. J.* 805-873 (2001).

B. The Domain of Law: The Conflict

The locus of the conflict was in the domain of law, which dictated the logic and language in which the issues were formulated. The operations of the network were separate and distinct from this sphere of operation and, from the perspective of its participants, largely irrelevant. The conflict consisted primarily of the reactions of US participants to the Commission decision, and thus a brief analysis of those reactions reveals the dynamics of the domain in which they operated.

1. Response Themes

Four themes were particularly prominent in US responses to the decision. These themes were common and influential, but not all US responses contain all the elements described here, and some differed significantly. The sample illuminates, however, the dynamics of the relationship.

One response was outrage that the EU would dare to prohibit a merger between two US companies that had been approved by US authorities. According to one account, “[...] Americans are asking how a foreign authority could scuttle a deal that involved only US companies and the Justice Department and about a dozen other competition authorities had approved with modest concessions.”⁹ The underlying assumption was that the EU simply had no right, legal or moral, to do what it did.

A second theme was that the decision was not based on the application of law, but was instead motivated by political considerations—specifically, the desire to protect domestic European industries. The economist Gary Becker claimed that “Europe appears to be guilty of caving in to powerful interests.”¹⁰ The claim is based on two assumptions: (1) that prohibiting the merger would benefit European competitors of US firms and (2) that such supposed benefits influenced the Commission’s decisions. Seldom, if ever, was evidence adduced in support of either claim.¹¹

A weaker form of this claim was that the system was “regulatory” in nature, and thus impliedly less “legal,” less neutral and less objective than the US system. The implication was that this allowed the Commission to pursue its own political objectives. According to one commentator, for example, “these differences [in

9 William Kolasky & Leon B. Greenfield, *The Lost GE/Honeywell Deal Reveals a Trans-Atlantic Clash of Essentials*, *Legal Times* 28 (July 30, 2001).

10 Gary Becker, *What U.S. Courts Could Teach Europe’s Trustbusters*, *Business Week*, Aug. 6, 2001, at 20. In a letter to the European authorities, Senator Ernest Hollings, Chairman of the Senate Commerce Committee, stated that the Commission had applied “an apparent double standard” that favoured European companies and disadvantaged their U.S. competitors.” U.S. Steps in over EU Opposition to G.E. Deal, *Financial Times*, June 16/17, 2001, at 1.

11 In fact, the most strenuous opponents of the merger were probably US firms rather than European firms.

outcome]—and the strengths and weaknesses of the two systems—flow from the fact that while the Antitrust Division [of the Justice Department] operates in a law enforcement context, the Merger Task Force [of the EU Commission] operates in a regulatory system.”¹²

A third claim, particularly common among antitrust specialists, was that the EU Commission was simply wrong in its analysis.¹³ Here the assumption was that the US and EU decision makers were applying the same standard and seeking the same objectives, but the EU misunderstood the economics of the case and thus got the analysis wrong. There was seldom explicit reference in such claims to the standard that was applied in arriving at this conclusion, and they seldom reflected careful comparison of the standards and objectives used in US and EU law.

Finally, and related, it was often claimed that the objectives of EU competition law were wrong—in the sense that they were inappropriate for competition law. A frequent claim was, for example, that “EU law protects competitors, while US law protects competition.” Charles James, Assistant Attorney General for Antitrust, stated in a press release that “clear and longstanding US antitrust policy holds that the antitrust laws protect competition, not competitors. Today’s EU decision reflects a significant point of divergence.”¹⁴ This claim perceives the differences in outcomes as the result not of faulty analysis based on similar standards, but of an unjustified discrepancy in objectives.¹⁵

2. *Underlying Assumptions*

These claims rest on basic assumptions and beliefs about law that were shared by the US participants in the network and were often assumed by them to be shared all participants in the legal domain. Their common point of reference is national legal experience.

One set of assumptions relates to the way competition law functions. It casts competition law decision-making as subject to political influence. The claim that the Commission was acting politically is not supported by evidence, and thus the conclusion that it was acting politically appears to be produced by the interpretive assumptions of those who made the claim rather than the evidence available.

12 Donna E. Patterson & Carl Shapiro, *Transatlantic Divergence in GE/Honeywell: Causes and Lessons*, 16 *Antitrust* 18, 22 (Fall, 2001).

13 See, e.g., William J. Kolasky, *Conglomerate Mergers and Range Effects: It's A Long Way from Chicago to Brussels*, address before the George Mason University Symposium, Washington, D.C., Nov. 9, 2001 (<http://www.usdoj.gov/atr/public/speeches/9536.htm>).

14 Charles A. James, *Statement on the EU's Decision Regarding the GE/Honeywell Acquisition* (July 3, 2001), available at: www.usdoj.gov/atr/public/press_releases/2001/8510.htm.

15 For discussion of this claim, see Edward T. Swaine, 'Competition, Not Competitors,' *Nor Canards: Ways of Criticizing the Commission*, 23 *U. Penn. J. Intl. Econ L.* (2002).

This is associated with the further assumption that legal decisions are specifically intended to promote the single-state interests of the decision-maker. The distinction here is between single-state and shared interests. Governmental decision makers generally pursue the interests of the state in which they operate; the issue is how they define those interests. The assumption at work in these responses is that the Commission acts to produce direct and tangible benefits to its domestic political constituents and that these interests take the form of advantages over the US competitors of European businesses. A shared interests perspective would also consider benefits to the state that may provide benefits to other states (e.g., more effective competition law development or more effective international cooperation).

Assumptions and beliefs about the relationship between law and economics form a further structural element in many US responses. They often assume that economics is the controlling language in competition law matters, that it represents an independent and universal standard against which competition laws are to be measured and assessed. Typically, this is accompanied by a further assumption that the economics standard is a specific form of economic analysis known generally as "Chicago school" analysis, which focuses on short-term price increases as the measure of economic efficiency.¹⁶ This conception of economic analysis is used as the standard to which all competition law systems should adhere.

This assumption is of crucial importance for two reasons. First, it disregards differences in the laws of the two systems and tends to preclude serious discussion of those differences. Where the discussion is reduced to the language of economics, other factors that a decision maker may be required or expected to take into consideration -- such as, e.g., the articulated legal standards provided by the laws being applied -- are excluded. The result may be to misunderstand and distort the decisional processes involved and the motivations of the decision makers. In the GE/Honeywell context, its implication is that EU decision makers were at liberty to act on what they considered to be the best economic analysis, regardless of existing statutes and policies. Second, it tends to disregard differences in economic analysis. Short-term price effects may currently be the sole concern in US antitrust, but that does not mean that they are the only concerns of economics.

A third set of assumptions involves the relationships among actors in the competition law arena. US responses assume certain characteristics of those relationships, and this leads to further assumptions about the probable effectiveness of particular response strategies.

The logic of power suffuses US responses. They frequently assume that US responses must not only be heard, but also heeded and followed. The tone is often

¹⁶ For a classic discussion of this approach, see Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* (1978).

that the US commentator has a right to expect that the Commission will make changes in accordance with her comments and that failure to do so (i.e., to follow the US example) will produce harmful consequences for the Commission. The fact of US power both encourages this type of response and implicitly turns such responses into threats.

In these responses, the relationships among competition law actors are seldom portrayed as legally imbedded. Existing principles of international law that obviously govern aspects of the relationship were seldom mentioned. For example, under public international law a state may apply its own law to conduct that has a substantial effect within its territory. This conclusion is based on the effects principle of international law, which is widely accepted as a general principle, although there continues to be controversy about its range and about how it should be applied in particular cases.

From this perspective, there is also little incentive to engage in serious comparative analysis—to learn about the traditions, objectives and dynamics of another system. Such knowledge appears to be, at best, useless; at worst, it may interfere with power-based response strategies. This logic may help to explain why US responses frequently lack rigorous analysis of the differences between the US and EU competition law systems and the reasons for them.

3. The Experience Base in US Law and Legal Culture

These assumptions and perspectives derive from US legal experience. That experience is both general and antitrust-related, and it has both external and domestic components.

On one level, the external influence is obvious. The experience of US political leaders, lawyers and academics since the Second World War has been one of leadership (some might say “dominance”) in its relationships with Europe. The political and economic power of the US has been accompanied by a general assumption in the US (and to some extent in Europe) that Europeans have an obligation to avoid serious interference with US goals. This power relationship easily leads to the further assumptions (1) that the US is “entitled” to tell the EU Commission what it should do and (2) that the EU Commission is “obligated” to heed US demands.

Perhaps less obvious is the experience of US antitrust lawyers and scholars in their relations with their analogues from foreign countries (mainly Europe). US antitrust law is often seen as the progenitor (usually, “father”) of antitrust law. Until after the Second World War, it was the only significant competition law, and it has long been the centre of the antitrust universe. Others, including the Europeans, have been expected to look to and learn from US antitrust law, and the Europeans have

frequently done so. Moreover, many still assume that European competition law is merely an import from the US.¹⁷

Among members of the US antitrust community, this has often generated an assumption that US antitrust law is simply better, more sophisticated and better developed than other competition law systems. In any event, they have seldom experienced situations in which they have been expected to learn from other competition law systems. As a result, the idea that the US can learn from others remains little developed, and this further contributes to an implicit sense of the superiority of the US system.

It also inhibits serious comparative analysis of EU competition law in the US. There is, of course, much writing and knowledge about particular cases and regulatory texts, but in-depth analysis of the goals, traditions, institutions and processes of European competition law remains uncommon in US legal discussions and scholarship.

The domestic experience of US antitrust lawyers and officials also helps to explain some of the assumptions that we have here encountered. Careful analysis of that experience can provide valuable insights into US responses, particularly because US experience of antitrust law is in many ways unique. Here are a few examples.

The assumption that antitrust officials are strongly influenced by political considerations is encouraged by US antitrust history. US antitrust law, and particularly US antitrust enforcement, has undergone fundamental and often rapid changes at several points in its history, and these changes have often been based on political factors. In some ways the most fundamental of these changes is very recent. I refer to the victory of law-and-economics methodology that began in the 1970s and radically changed much in US antitrust law. These changes are often assumed to have been to a large extent driven or at least supported by political factors, most notably the policies of Ronald Reagan's presidency. This experience tends to predispose members of the US antitrust community to assume that such political factors play similar roles in other systems as well.

This is further related to attitudes toward administrative decision making that are common in society, but particularly prevalent within the competition law community. In the US, administrative officials are often assumed to be vulnerable to political pressure, and this assumption is readily applied in the area of antitrust because of the magnitude of the economic and political interests that are often involved in antitrust decisions. This set of beliefs about administrative decision-

17 I have demonstrated that this assumption is inaccurate, but it persists nonetheless. For discussion of the evolution of competition law in Europe and the role of U.S. antitrust law in that evolution, see David J. Gerber, *Law and Competition in Twentieth Century Europe* (1998, pbk. 2001).

making, particularly in the competition law arena, is readily applied to all systems. Given that administrators play a more central role in the application of EU competition law than they do in the US, the step to assuming political vulnerability in that system is a short one.

In the US system, the political vulnerability of administrators is thought to be offset by the central role of the federal courts in the system. For example, the Department of Justice generally must file suit in court in order to transatlantic enforcement action under the antitrust laws. This is understood as a mechanism for constraining political influence within the system. In the EU context, the Commission has extensive decisional and enforcement powers that are used with little or no court involvement. Its decisions may be reviewed by one of the two Community courts, but reviews often take several years, and relatively few have led to reversal of Commission decisions. This encourages suspicions about the Commission's objectivity as well as its motives.

The most prominent element of US antitrust experience over the last 25 years has been the victory of law and economics. Not surprisingly, this victory plays key roles in the shaping of US antitrust views. In particular, it shapes the way members of the US antitrust community view both the phenomenon of competition law and those who hold other views of competition law.

Beginning in the late 1970s, scholars identified with the "law-and-economics" (L&E) movement have argued that the goals of antitrust should be defined *solely* by reference to economic theory, in particular, the Chicago school of economics. This recent, rapid and impressive "victory" has generated belief in the rectitude of the ideas, and it helps to explain why they have come to form a kind of orthodoxy in the US. The speed and ease of the victory are often seen as proof of their power: if they can be so successful in such a short period of time, they must be powerful. From here the step to assuming that they are also "right" in a universal sense is easy and often taken.

The experience of this victory has also created a kind of post-victory mode of thought, according to which the battle has been won, and ideas that prevailed previously have been shown to be wrong. Some of these ideas are perceived to be similar to ideas advanced by the European Commission, leading some members of the US antitrust community to discredit them by association.

This brief review of the GE Honeywell conflict highlights the distinctive operations of the two domains that operate within transatlantic governance. It also demonstrates important elements of the relationship, particularly the extent to which the conflict was a product of the logic and status of the domain of law in the transatlantic governance relationship. Finally, it demonstrates some of the ways in which domestic experience with law and legal culture shape interactions within the domain of law.

V. Potential Policy Implications

This analysis has potential policy implications. I note here a few examples. I assume for purposes of discussion that there are two policy goals:

- 1) To increase the effectiveness of competition law in influencing business decisions, and
- 2) To reduce conflicts within the governance relationship.¹⁸

Given the above analysis, this should generate strategies designed to increase the influence of the network domain. That domain conceives the relationship in cooperative, conflict-reduction terms, and it functions in ways that favour such outcomes. Assuming that other factors remain unchanged, therefore, increasing the influence of that domain should favour the designated objectives.¹⁹

A detailed analysis would, of course, also include reference to the points at which changes in the role or function of the network could be expected to alter its dynamics. If, for example, the network were to become more influential, outside interests would have greater incentives to seek to influence its operations. This level of analysis is beyond the scope of this essay, but the analysis suggested here identifies the conditions of network operations and thus provides the basis for a more extended analysis.

One strategy would be to increase the scope of network operations. If network decision making is more likely to lead to the objectives stated, then increasing the scope of those operations should promote the attainment of those goals. Even small steps could be of benefit here. For example, under the current legal regime, most information exchanges handled by the network in specific cases are voluntary—i.e., they must be approved by the parties involved. By expanding the scope of information exchanges to include some that are not voluntary in this sense, the potential influence of the network may also increase.

A second strategy would be to increase the influence of the network image of the governance relationship.²⁰ That image portrays the relationship as cooperative and conflict-resistant. If more participants in the relationship were to view it that way, this may, depending on the circumstances, lead to increased expectations of conduct consistent with this image and to conduct modification consistent with those expectations. This strategy might include steps as simple as increasing resources for disseminating information about network operations.

18 These objectives are, of course, contestable. Some would suggest, for example, that such conflicts serve useful functions.

19 Network analysis is attractive for some precisely because of its apparent propensity to foster such goals.

20 This could also generate a different result, depending on the circumstances. It could, e.g., lead to increased resistance from those opposed to the network view of the relationship.

Another strategy focuses on conceptions of law. The conception of law that tends to generate conflict within law's domain is based on national rather than international law. As we saw in the GE/Honeywell context, equating law with national law and, therefore, viewing transnational relations in terms of national power and/or national interest tends to generate conflicts. If, however, the perceived relevance of *international* law were to increase within the domain of law, this could be expected to lead to increased consideration of reciprocal duties and obligations within that relationship and reduce not only the points of conflict, but also the incentive to attach interests to specific points of difference between legal systems. Specific international agreements regarding competition law (e.g., in the context of the WTO) could be expected to alter thinking in this direction by requiring domain participants to pay increased attention to the international rather than merely the national dimensions of law.

Finally, as we have seen, law's domain is rooted in national experience, whereas the experiential point of reference for the network is transnational. Changing the experience base of participants in law's domain and/or expanding awareness within the legal domain of cooperative experience within the network may also increase the influence of cooperative experience. One specific way of supporting this influence may be, for example, to create a joint commission to evaluate potential conflict situations within the transatlantic relationship. Its members might include influential academics, political figures and business leaders as well as network participants—from both sides of the Atlantic. Experience in this group would develop a shared reference base of experience that would be similar to that of regulatory cooperation and may over time lead to similar patterns of thought among its members.

VI. Concluding Remarks

This essay suggests the potential value of developing an analytical framework that is capable of detecting distinct domains within governance relationships. Applying such a framework to the transatlantic economic governance relationship yielded insights that otherwise might not have been detected. It revealed two distinct domains of the relationship. Each influences decisions in systematic ways, and each influences the other in detectable ways. Distinguishing these distinct modes of operation and thought then allowed us to detect forces within the relationship that had been rarely been noted, if at all.

Existing analytical tools—e.g., network theory, rational choice theory, and public choice theory—reveal aspects of the transatlantic governance relationship, but each also misses significant elements of it. The framework sketched here relates them to each other and thus yields a richer, more nuanced and, hopefully, more accurate image of that relationship.

Comments

Stephen R. M. Wilks

Here we have two sophisticated papers from two of the leading figures in the comparative study of competition law and policy. The presentations have added vibrancy and richness to the papers and it is difficult to know where to start. I propose to take three cuts at commentary to cover first, reflections on their analysis; second, to talk about some "dogs that did not bark"; and thirdly, some comments on convergence of regimes.

First, reflections on the analysis. Both papers stress the success of the network of relationships built up between competition practitioners. In his presentation William Kovacic actually referred to the "manic" level of interaction between governments and individuals involving conferences and meetings of professional associations. Regular interaction has become the norm and it involves extensive exchange of information and rests on great goodwill.

But both papers also identify disappointments with the outcomes from networking and they emphasise the distance still to travel. Kovacic does this implicitly by sketching out an agenda of future engagement, and it is an ambitious agenda aimed at facilitating real understanding. David Gerber does this explicitly by underlining the very limited impact that the network domain has had on actual conflictual cases, especially of course GE/Honeywell, so that there is a disjuncture between the network domain and the legal domain.

What explains this disappointment? One reason is that the legal systems remain very different. That's rather an obvious statement and it would matter less if the two sides recognised and understood the differences. However it is clear that the Europeans on the whole do not understand American antitrust. Moreover, not only

do the Americans not understand European competition law, they are—to use Gerber's phrase—“outraged” at the extraterritorial impact of European decisions. So both papers stress the need for reciprocal in-depth analysis not only of the cases but of the history and the basic dynamics of the two systems. This is hugely important.

This legal incomprehension is of decisive importance for Gerber because policy implementation through law takes cases out of the control of the network. Cases become debated in terms that may be legal but are also politicised and nationalised so that the imperatives of cooperation are sidelined. For me as a political scientist a key factor is that both papers stress fundamental differences between legal and institutional systems. In Kovacic's formulation “how institutional change affects doctrine” is vital. For instance his fascinating and perceptive account of how private actions and triple damages provoke judicial caution which spills over to narrow the scope of public action in the US and thus creates a perverse impact.

This brings me on to my second area. With apologies to Sherlock Holmes it concerns “dogs that did not bark”. Let me touch on five areas where we might also have expected some discussion.

Initially there is the question of multi-lateralism. Both papers stress bi-lateral engagement. Kovacic mentions some of the many multi-lateral initiatives (such as the well established OECD network and the newer International Competition Network) but it is notable that competition policy has not created international agencies or treaties. Why is this? Is it too law driven? Too market specific? Is there no real business pressure?

Then there is the interaction with trade policy. One of the sources of solidarity amongst competition policy specialists and practitioners has been the need to counter the powerful and historically predominant trade policy community. At the extreme trade policy doctrine would hold that complete liberalisation of trade would render competition policy redundant. While no competition policy advocate would accept that for a moment it is true that globalisation does alleviate some competition concerns and the collapse of international trade policy initiatives might have an impact on competition policy. We could discuss how competition policy has become more politically salient?

A third area is concerned more with the analysis and in particular I wonder whether there is a need to define “the network?” Gerber talks about “the network.” Kovacic discussed the “competition policy community.” Neither paper defines the membership and the dynamics of “the community” and I wondered if we should develop that concept. In particular, the literature on “epistemic communities” is very suggestive. An epistemic community is an international network of experts unified and mobilised by ideas. In this areas the experts centred around Claus-Dieter Ehlermann or Mario Monti constitute examples of communities and they appear

very influential. But they appear much more influential in making policy than in implementing it.

Moving on, neither paper says very much about the role of business, the private sector companies who have a keen interest in the form and effectiveness of competition law. Do companies want a common transatlantic regulatory framework? How much influence do they have? Do companies actually oppose a more effective cooperative regime and isn't the real challenge to educate companies and increase compliance?

My final silent dog relates to the impact of competition policy. How should we assess the impact of policy and do the US and Europe have a shared philosophy of policy targets? Should competition policy control economic power; or should it protect consumers; or should it increase competitiveness? The Americans have accused the Europeans of protecting competitors rather than competition but it may also be that European policy has been skewed by the nature of European capitalism. I was especially struck by Kovacic's comments about the need for "competition policy R&D." In other words for far more systematic research on competition policy which offers a role and a challenge for academics. One element of this for me would be to ask whether US-style competition policy is well adjusted to commercial realities. Is it well adjusted to what we can call "Rhine-land capitalism" with its sensitivity to the social implications of intense competition? Is competition policy perhaps too Anglo-American for much of continental Europe? Capitalist traditions that stress stakeholder involvement in companies and cross shareholdings, as in Germany, may still be accountable and efficient but may be threatened by competition policy. There has, for instance, been some recent thinking out loud by DG-Competition about whether cross-shareholding of the sort that virtually define the German corporate economy may actually be illegal under European competition law.

Can I conclude these comments with the big question of "convergence." The UK has converged on American concepts. We have incorporated the US-style SLC (substantial lessening of competition) test into our new merger laws and the new EU merger regulation also make reference to SLC. Moreover Mario Monti, the outgoing European Commissioner, also talks about European convergence on US approaches. There is no question that Europe has changed. European antitrust is now a cornerstone of economic governance in a way that it certainly was not twenty years ago—and look at the ten new members whose socialist economies have been transformed and now comply with the competition rules! But the message of these two papers is that the US should take European competition policy more seriously, both American officials and American companies. Is it time that the US itself ought to engage in some introspection and reform? In Gerber's terminology, has the child outgrown the parent?

Finally can I say how much I have learned from these two papers and how much I am aware of the depth of knowledge that underpins the. Papers of this calibre provide some reassurance that the comparative "competition policy R&D" can be achieved but it also needs to be disseminated.

Chapter 6

Privacy, Personal Data Protection and the Safe Harbour Decision From Euphoria to Policy. From Policy to Regulation?

*María Verónica Pérez Asinari
Yves Poulet*

I. Introduction

International trade took digital form in a sort of technological and market euphoria. Even if the “extreme” euphoria of the 90’s has calmed down after the dot.coms crisis this new form of exchange has come to stay with us and became to be the most natural thing.

The advantages of information technologies in regards to multilateral economic relations were early pointed out as a key element of the transatlantic political dialogue. The Transatlantic Agenda mentions the will to create a New Transatlantic Marketplace and a Transatlantic Information Society, both of these in the frame of the third shared goal: “contributing to the expansion of world trade and closer economic relations.”¹

In the context of the digital marketplace, many national and multinational companies export and import personal data on a regular basis, for their management activities (human resources, customer care, direct marketing, etc.). Personal

1 Transatlantic Agenda, available at: <http://www.eurunion.org/partner/agenda.htm>.

information may even be their raw material for market research, profiling, etc., what can constitute the service itself or an added value to their "product" or "commodity." Apart from this, and due to the architecture of Internet protocols, consumers leave traces while using the net, sometimes consciously (e.g. when they purchase goods or contract services in e-commerce platforms and their name, address and other information is required for the deliverance), sometimes unconsciously (e.g. through the use made by companies of clickstream data, when cookies are placed on their hard drives, when invisible hyperlinks are used, etc.).² Thus, personal data, as information on the net, crosses states' borders very easily. It can be re-used for many other purposes than the purpose for which it has been initially gathered. Moreover, assisted by very cheap software, the result of this further data processing contributes to an economically viable result.

Given this reality, any dialogue about the digital marketplace policy must involve a concomitant dialogue on privacy and personal data use policy, due to the risks to certain rights of the individual that an uncontrolled use of personal data can create.

This paper will analyse, first, what were the initial political aims of the EU-US dialogue in the realm of the New Transatlantic Agenda (NTA) and related documents. Secondly, a brief description will be given of the EU and US regulatory choices in the privacy arena, aiming to provide the legal background for framing any effort of joint governance. Thirdly, we will analyse if there have been efforts of joint governance, and if so, how have these efforts worked in practise: the Safe Harbour Decision, whether there have been impediments for a successful cooperation, and if so, what institutions and/or practises have been most effective at overcoming such obstacles. Fourthly, we will assess what concrete steps might the US and the EU undertake in the coming months and years, to strengthen cooperation and attain their common goals. Finally, we will conclude by assessing to what extent policy was translated into regulation (State regulation, co-regulation, self-regulation, regulation through technology).

2 J-M. Dinant Law and Technology Convergence in the Data Protection Field? Electronic Threats on Personal Data and Electronic Data Protection on the Internet, Deliverable 2.2.3, ECLIP, Project funded by the EC, IST programme, available at: http://www.eclip.org/documents/deliverable_2_2_3_privacy.pdf, last visited 31/05/04. J-M. Dinant Les traitements invisibles sur Internet, *Cahiers du CRID n°16*, Bruylant, 1999, pp. 271-294, also available at: <http://www.droit.fundp.ac.be/crid/eclip/luxembourg.html>, last visited 31/05/04. C. Ducourtieux and S. Foucart Les profiteurs du Net traquent les internautes à leur insu, *Le Monde*, 10 May 2002, page 20.

II. Initial Political Aims: The NTA's Perspective on Privacy and Personal Data Protection

The NTA does not specifically mention, in its third shared goal, any reference to privacy or personal data protection. Even when it refers to issues where trade intersects with other concerns, the document points out only the "environment, internationally recognised labour standards and competition policy." Could one imagine that there was no important intersection between trade and privacy or that this concern was still not obvious at the time when the NTA was drafted? We will see that it was not the case.

However, two other political documents highlight an intrinsic relationship between trade and the protection of privacy and personal data: (1) the Joint EU-US Action Plan³ that accompanies the NTA, and (2) the Joint Statement on Electronic Commerce.⁴

The Joint EU-US Action Plan sets out specific actions to which the EU and the US have committed themselves, describing concrete steps to carry out in order to achieve each of the four-shared goals. While addressing the New Transatlantic Marketplace, the document foresees that:

- [W]e will expand and develop the bilateral Information Society Dialogue, in order to further common understanding of global issues implying access to information services through public institutions, regulatory reforms, and technological cooperation, including the continuation of expert-level discussions in the following areas: [...] commercial communications; privacy and data protection...⁵
- Furthermore, it refers explicitly to "data protection" in the following terms: [W]e will discuss data protection issues with a view to facilitating information flows, while addressing the risks to privacy.⁶

Clearly said, it means that even if privacy concerns must be taken into consideration, they might not affect disproportionately information exchange. Moreover, despite the fact that this document was supposed to "specify" concrete actions, it seems that this field remained in a "discussion" stage. The will/need to regulate or not regulate the privacy field was not mentioned.⁷

3 Joint EU-US Action Plan, available at: <http://www.eurunion.org/partner/actplan.htm>.

4 Joint Statement released in conjunction with the EU-US Summit in Washington, DC, December 5, 1997, available at: <http://www.eurunion.org/partner/summit/Summit9712/electrst.htm>.

5 Point III.2.(i) devoted to "Information Society, information technology and telecommunications."

6 Point III.2.(k).

7 The degree of cooperation is quite diverse in the different topics addressed. Very concrete commitments are made in other areas. For instance, in Point III.2.(d) "Veterinary and plant

The Joint Statement on Electronic Commerce establishes certain guidelines for the global expansion of e-commerce. Some statements are made, as far as governance choices are concerned, that goes in -what could be understood as- either "contradictory" or "complementary" ways. The document stipulates, in the relevant part, that:

- [Such] expansion will be essentially market-led and driven by private initiative;⁸
- The role of the government is to provide a clear, consistent and predictable legal framework, to promote a pro-competitive environment in which e-commerce can flourish and to ensure adequate protection of public interest objectives such as privacy, intellectual property rights, prevention of fraud, consumer protection, and public safety;⁹
- Industry self-regulation is important. Within the legal framework set by the government, public interest objectives can, as appropriate, be served by international or mutually compatible codes of conduct, model contracts, guidelines, etc., agreed upon between industry and other private sector bodies;¹⁰
- Finally, the parties agree, among other issues, to work towards:
[E]nsuring the effective protection of privacy with regard to the processing of personal data on global information networks.¹¹

In this case, the political instrument is more explicit, but fuzzy still. Hence, the document pleads in favour of a co-regulatory¹² model founded on a certain partition

(contd.)

health issues," it is stated that "[w]e will conclude an agreement to establish a framework for determining equivalence of veterinary standards and procedures for all live animals products." Point III.2.(h) "Customs cooperation" declares, in the same line that the previously mentioned one, that "[w]e will endeavour to conclude by the end of 1996 a customs cooperation and mutual assistance agreement between the EC and the US. The agreement should cover...."

8 Point 3(i).

9 Point 3(ii).

10 Point 3(iii).

11 Point 4(iv).

12 More recently this partition of responsibilities has also been promoted by the World Summit on the Information Society (WSIS) Declaration of Principles when this Declaration asserts: "The management of the Internet encompasses both technical and public policy issues and should involve all stakeholders and relevant intergovernmental and international organizations. In this respect it is recognized that:
Policy authority for Internet-related public policy issues is the sovereign right of States. They have rights and responsibilities for international Internet-related public policy issues;
The private sector has had and should continue to have an important role in the development of the Internet, both in the technical and economic fields;
Civil society has also played an important role on Internet matters, especially at community level, and should continue to play such a role;

of responsibilities among the State and private parties in the regulatory process. Privacy is one of the key issues for the e-commerce political framework, but there is neither a definitive determination about the regulatory choice to address this important issue, nor the compromise for the signature of an agreement, as is the case in other areas of the NTA.¹³ It has to be noted that there is a dual reinforcement: on the one hand the role of the government in those areas where there is a public interest, and on the other, the role of private sector self-regulation in serving also those public interest objectives. Not surprisingly enough, the EU-US debate on privacy and data protection will be played in those extremes (as Internet governance in general),¹⁴ to find an eclectic and not definitive¹⁵ solution: the Safe Harbour (SH) framework.

III. Regulatory Choices in the EU and in the US

These political documents above mentioned seem not to have been "naive" when leaving a blurred sensation about the regulatory choice. Indeed, this was (and still is) an intricate political and legal matter, where both parties have taken different roads for regulation. Indeed, this makes joint governance more difficult in this realm. A solution was a must, being information (remarkably "personal" information) the petrol of the digital marketplace. But, have there been truly "joint governance" efforts in the practise? We have to understand first the legal framework of both parties separately, in order to see how the joint political basis

(contd.)

Intergovernmental organizations have had and should continue to have a facilitating role in the coordination of Internet-related public policy issues;

International organizations have also had and should continue to have an important role in the development of Internet-related technical standards and relevant policies."

The WSIS has been organised by ITU in Geneva (10-12 December 2003). As previously decided, this first meeting will be followed by a second meeting to be held in Tunis in 2005. The WSIS was the result of difficult, numerous and intense discussions at regional and global level. See: World Summit on the Information Society, Declaration of Principles. Building the Information Society: a global challenge in the new Millennium. Document WSIS-03/GENEVA/DOC/4-E. 12 December 2003, available at: http://www.itu.int/dms_pub/itu-s/md/03/wsis/doc/S03-WSIS-DOC-0004!!MSW-E.doc.

13 See footnote 7.

14 See: J. Berleur, E. Brousseau, M. Cojpek, T. Delmas, T. Dedeurwaerdere, T. Ewbank de Wespim, I. Falque-Pierrotin L. Hennuy, Ch. Lazaro, C. Maesschack, Y. Pouillet, R. Queck Enjeux à débattre. Gouvernance de la société de l'information. Loi. Autoréglementation. Éthique, Actes du séminaire, Namur, les 15 et 16 juin 2001, Bruxelles, Bruylant, 2002. Y. Pouillet How to regulate Internet: New paradigms for Internet Governance self-regulation: value and limits, Variations sur le droit de la société de l'information, Bruxelles, Bruylant, 2002, pp. 79-114. Y. Pouillet De retour d'un sommet mondial de la société de l'information. Revue du Droit des Technologies de l'Information, no. 18, avril 2004, pp. 5-8.

15 We will see infra why, in our opinion, the SH is not a definite solution.



was intended to be transmitted into practical and legal solutions, to contribute to the achievement of the NTA third shared goal.

Regulatory choices go beyond the very topic of this paper. State legislation, co-regulation, private sector self-regulation, or technological regulation are the result of historical, cultural, economic, etc., choices of a given society. They are not "good" or "bad" in themselves, they depend on many other contextual premises and the application fashion to the concrete cases.¹⁶ Comparison of these choices and the results in practise are often conducted in this arena, due to the differences they present, mainly, in the regulation of privacy and personal data protection in e-commerce and other Internet and new technologies applications.¹⁷ In what follows, we will have an approximation to the regulatory solutions the parties under analyses have adopted.

A. The European Framework

The European Convention for the Protection of Human Rights and Fundamental Freedoms¹⁸ regulates the protection of privacy as follows:

Article 8: (1)

Everyone has the right to respect for his private and family life, his home and his correspondence.¹⁹

At supranational level, EU Community law has moved from being a pure economic integration process, to a more comprehensive framework. It has incorporated the protection of human rights, as one of its goals since the adoption of the Treaty of Amsterdam.²⁰ The draft Treaty establishing a Constitution for

16 Based on Summers's doctrine, we do propose a triple test of the legal validity of both self-regulatory norms and public regulations: legitimacy- conformity and effectiveness. On these triple criteria, see our reflections: Y. Poulet, "ICT and Regulation; Towards a New Regulatory Approach," to be published in *Internet Governance*, M. Schellekens (ed.), Kluwer Law Int.

17 See: G. Shaffer "Globalization and Social Protection: the Impact of EU and International Rules in the ratcheting up of US Data Privacy Standards," *Yale Journal of International Law*, Winter 2000, vol. 25, pp. 1-88. J. Dhont and M.V. Perez Asinari "New Physics and the Law. A Comparative Approach to the EU and US Privacy and Data Protection Regulation," in *L'utilisation de la méthode comparative en droit européen*, ed. F. van der Mensbrugge, Presses Universitaires de Namur, Namur, 2003, pp. 67-97. C. Manny "European and American Privacy: Commerce, Rights and Justice," *The Computer Law and Security Report*, Vol. 19, No. 1, pp. 4-10, and Vol. 19, No. 2, pp. 92-100.

18 Referred to in Article 6 of the TEU and Article 286 of the TCE.

19 European Convention for the Protection of Human Rights and Fundamental Freedoms, Rome, 4 November 1950, available at: <http://www.echr.coe.int/Convention/webConvenENG.pdf>.

20 Treaty Establishing the European Community, available at: http://europa.eu.int/eur-lex/en/treaties/dat/EC_consol.pdf.

Europe²¹ has even included the Charter of Fundamental Rights of the European Union. Despite the fact that this instrument is not in force yet, it shows an important advance: the provision of an autonomous fundamental right to the protection of personal data,²² as individuated from the right to privacy.²³ Privacy is no more envisaged only as a way to protect sensitive data and the confidentiality of communications but more broadly and more positively, as a way for ensuring the ability of human beings to their self-determination in an Information Society, where information might be considered as a power for data controllers *vis-à-vis* the data subjects.²⁴

The exchange of personal data across boundaries was early analysed in the—at that time—EEC from the perspective of the internal market: due to the adoption of privacy and data protection laws in different Member States²⁵ obstacles to the free flow of data could be created due to the disparity of legislation.

The 80's and beginning of 90's are characterised by the effort to find international solutions: the OECD Guidelines on the protection of Privacy and Transborder Flows of Personal Data,²⁶ the Council of Europe Convention no. 108 on the protection of individuals with regard to automatic processing of personal data,²⁷ and the UN Guidelines for the Regulation of Computerized Personal Data Files.²⁸ We can see that the nature of the instruments is different. Whereas the

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- 21 Draft Treaty establishing a Constitution for Europe, Adopted by consensus by the European Convention on 13 June and 10 July 2003, submitted to the President of the European Council in Rome, 18 July 2003, available at: http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/c_169/c_16920030718en00010105.pdf.
- 22 Article 8: 1. "Everyone has the right to the protection of personal data concerning him or her. 2. Such data must be processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law. Everyone has the right of access to data which has been collected concerning him or her, and the right to have it rectified. 3. Compliance with these rules shall be subject to control by an independent authority."
- 23 Article 7: "Everyone has the right to respect for his or her private and family life, home and communications."
- 24 On this evolution, see D. Solove, "Conceptualizing Privacy," 90 California Law Review (2002), pp. 1088 and ss.
- 25 Land of Hesse (1970); Sweden (1972); Federal Republic of Germany (1977); Denmark (1978); France (1978); Luxemburg (1979).
- 26 OECD Guidelines on the protection of Privacy and Transborder Flows of Personal Data, 23 September 1980. Available at: <http://www.oecd.org/dsti/sti/it/secur/prod/PRIV-EN.IITM>.
- 27 Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data ETS no. 108, Strasbourg 28 January 1981. Available at: <http://conventions.coe.int/treaty/en/Treaties/Ihtml/108.htm>.
- 28 Guidelines for the Regulation of Computerized Personal Data Files, Adopted by General Assembly resolution 45/95 of 14 December 1990, available at: <http://www.unhchr.ch/html/menu3/b/71.htm>.

OECD Guidelines and the UN Guidelines are examples of soft law, Convention no. 108 is the first international binding document. All of them have been the source of the upcoming EU rules.

Some months before the signature of the NTA, Directive 95/46/EC²⁹ was enacted, in order to harmonise divergent Personal Data Protection legislation in what concerns the protection of fundamental rights and freedoms of natural persons (in particular their right to privacy with respect to the processing of personal data), to fulfil the internal market's requirement of free flow of personal data. As a consequence, it establishes some general principles in order to achieve this goal, describing rights for the data subject and obligations for the data controller when processing personal data.

Basically, it foresees that the data subject³⁰ has the rights to information,³¹ access,³² rectification, reassurance and blocking.³³

The data controller³⁴ has to respect the data quality principles,³⁵ the legitimacy of processing activities,³⁶ she has to notify the national Data Protection Authority the processing activities,³⁷ and she has to implement appropriate technical and organizational measures.³⁸

Furthermore, to avoid the circumvention of European law, the Directive has created a mechanism, that consists in a general principle for trans-border data flows (TBDF) and a series of exceptions. Indeed, Article 25(1) of the Directive sets out the principle that Member States shall only allow a transfer to take place if the third

29 Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, OJEC L 281, 23/11/1995 P. 0031-0050. Hereinafter: "the Directive."

30 The "data subject" is the person to whom the data relates. "Personal data" is defined as: "any information relating to an identified or identifiable natural person ("data subject"); an identifiable person is one who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity," Article 2(a) of the Directive.

31 Article 10 and 11 of the Directive.

32 Article 12(a) of the Directive.

33 Article 12(b) of the Directive.

34 The "data controller" is "the natural or legal person, public authority, agency or any other body which alone or jointly with others determines the purposes and means of the processing of personal data; where the purposes and means of processing are determined by national or Community laws or regulations, the controller or the specific criteria for his nomination may be designated by national or Community law," Article 2(d) of the Directive.

35 Article 6 of the Directive.

36 Article 7 of the Directive.

37 Article 18 of the Directive.

38 Article 17 of the Directive.

country in question ensures an "adequate level of protection."³⁹ This basic principle, forbidding any TBDF to countries not offering adequate protection might suffer certain exceptions: (a) certain specific derogations (Article 26[1]); (b) adequacy Decisions (Article 25[6]); and (c) protection taken by the sender and the receiver of the TBDF either by contractual means or by their common subjection to legally binding commitments (Article 26[2]).

Before analysing further the different means to ensure an appropriate protection in case of TBDF, let us make a parenthesis here to analyse, very briefly, the concept of "flow" to determine which situations would be regulated under Article 25(1). The term is not defined in the Directive. A dictionary defines this term as "[t]he action and fact of flowing; movement in a current or stream; an instance or mode of this. Orig. said of liquids, but extended in modern use to all fluids, as air, electricity, etc."⁴⁰ We have the idea of movement and also the connection with things that can go from one place to another without recognising frontiers, like the case of the air. A dictionary of informatics defines more precisely the expression "trans-border data flows" as:

*[C]irculation internationale par télécommunications des données de toutes natures (économiques, techniques, etc.) posant des problèmes multiples: dépendance vis-à-vis des détenteurs de l'information (banques des données), protection des données et de la vie privée, traitement extraterritorial de l'information entraînant un déplacement de la prise de décision.*⁴¹

It is interesting to see that the concept "international circulation of data by telecommunications" is very broad and can represent multiple situations.

In our sphere, this is the case of a company transmitting a database of clients, of potential customers, of employees, of business contacts, etc., to its partner or branch established outside the EU. It is also the case of a customer transferring her personal data via an e-commerce website located in another country in order to receive a good or service.⁴² Yet, is it the case of personal data made available on the Internet,

39 This concept of "adequate protection" has been taken again by the Additional Protocol to the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, regarding supervisory authorities and transborder data flows CETS No.: 181, Strasbourg, 8 November 2001.

40 A New Dictionary on Historical Principles, Ed. J. Murray, Oxford at the Clarendon Press, 1901, vol. IV.

41 M. Guinguay and A. Lauret, Dictionnaire d'informatique, 5e édition, Masson, Paris, 1992.

42 Even if this case constitutes a "flow" of personal data, it is not covered by the application of the Directive since the data controller, the person responsible for the website who decides the means and purposes of this data processing, is neither established on the territory of one member state—Article 4.1(a)—nor is making use of equipment located in the EU—Article 4.1(c).

which can potentially be accessed by people in third countries? Does this data “flow” from one country to another? Quite surprisingly, the European Court of Justice (ECJ) has understood this as not being a flow.⁴³

In a recent decision, the ECJ concluded that:

[T]here is no transfer [of data] to a third country within the meaning of Article 25 of Directive 95/46 where an individual in a Member State loads personal data onto an internet page which is stored on an internet site on which the page can be consulted and which is hosted by a natural or legal person who is established in that State or in another Member State, thereby making those data accessible to anyone who connects to the internet, including people in a third country.

The ECJ based this decision on the fact that Chapter IV of the Directive contains no provision concerning use of the Internet. Furthermore:

[I]f Article 25 of Directive 95/46 were interpreted to mean that there is a transfer [of data] to a third country every time that personal data are loaded onto an internet page, that transfer would necessarily be a transfer to all the third countries where there are the technical means needed to access the internet. The special regime provided for by Chapter IV of the directive would thus necessarily become a regime of general application, as regards operations on the internet. Thus, if the Commission found, pursuant to Article 25(4) of Directive 95/46, that even one third country did not ensure adequate protection, the Member States would be obliged to prevent any personal data being placed on the internet.

Coming back to the notion of flow and giving consideration to the technical perspective, each time an Internet user consults a website, information packets are transmitted via routers. If, the final destination of this packet is located abroad (that is, the place of establishment of the user who consult the website, and who can process⁴⁴ the data consulted) the information has been exported, so, there has been an international transfer or flow of personal data.

It is rather astonishing, then, that the Court have not considered this technical reality. Indeed, the way to solve legal problems derived from the application of technology is not the denial of the effects that technical reality cause, but the

43 Judgment of the Court of 6 November 2003, Criminal proceedings against Bodil Lindqvist, Case C-101/01. Another problem is the case of “flows” generated by cookies or invisible hyperlinks. Should we apply Article 4.1(c) of the Directive, or both Article 4.1(c) plus the rules on TBDF?

44 The notion of processing activity given by the Directive is very broad: “any operation or set of operations which is performed upon personal data, whether or not by automatic means, such as collection, recording, organization, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, blocking, erasure or destruction,” Article 2(b) of the Directive.

understanding of the need not to leave the cyberspace in anarchy, and the application of the existing law as far as it is legitimate. For instance, the ECJ could have considered that the exceptions to the application of Article 25(1), as described in Article 26(1) (see *infra*) are almost the same that the requisites described in Article 7 of the Directive⁴⁵, which constitute the criteria for making a data processing legitimate. In those cases, then, if the processing activity consists in posting personal data on an open network, given the international character of it, and the fact that due to the technical state-of-the-art this posting implies the possibility that an indefinite number of people located abroad have access (and if desired further process) to this data, information to the data subject about this possibility of global access should be required. With this, the data subject would be more aware about the risks that could arise to her data if not adequately protected.

With the reasoning of the ECJ, if a data controller posts personal data on a website legitimised by Article 7(a) of the Directive (unambiguous consent), the given consent of the data subject would even be "informed" and valid if the controller does not mention the fact that this data can be accessed and further processed in countries where there is no or less protection. Could we really consider this consent as "informed?"

Indeed, the main difference between Article 26(1) and Article 7 is its paragraph (f), which stipulates:

Member States shall provide that personal data may be processed only if:

[...]

- (f) processing is necessary for the purposes of the legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject which require protection under Article 1.

When a transfer can not be covered by any of the exceptions of Article 26(1), being the processing legitimate in accordance to Article 7(f), the data controller can

45 Article 7: "Member States shall provide that personal data may be processed only if: (a) the data subject has unambiguously given his consent; or (b) processing is necessary for the performance of a contract to which the data subject is party or in order to take steps at the request of the data subject prior to entering into a contract; or (c) processing is necessary for compliance with a legal obligation to which the controller is subject; or (d) processing is necessary in order to protect the vital interests of the data subject; or (e) processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the controller or in a third party to whom the data are disclosed; or (f) processing is necessary for the purposes of the legitimate interests pursued by the controller or by the third party or parties to whom the data are disclosed, except where such interests are overridden by the interests for fundamental rights and freedoms of the data subject which require protection under Article 1 (1)."

seek legitimacy for the transfer in any of the other possibilities offered by the Directive (see *infra*). However, in the case of Internet postings, the other possibilities do not offer a global solution, as is the case of Article 26(1). These other possibilities offer country or country-sectoral solutions (adequacy Decisions) or controller-to-controller/controller-to-processor specific-case solutions (standard contractual clauses). This does not mean that given the flexibility of Article 25(2) of the Directive, other solutions addressing global issues could not be found.

This finding itself and the concept of “flow”—from a theoretical and practical point of view—deserve, clearly, a deeper analysis. However, we could not avoid mentioning it here, due to the direct implication with the subject of this paper.

Coming back to the notion of “adequate” protection, we have to bear in mind that, this concept has to be linked to the degree of risk a transfer presents and to the nature of the data:

The adequacy of the level of protection afforded by a third country shall be assessed in the light of all the circumstances surrounding a data transfer operation or set of data transfer operations; particular consideration shall be given to the nature of the data, the purpose and duration of the proposed processing operation or operations, the country of origin and country of final destination, the rules of law, both general and sectoral, in force in the third country in question and the professional rules and security measures which are complied with in that country.⁴⁶

Directive 95/46/EC does not provide for a definition of “adequacy.”⁴⁷ The Article 29 Data Protection Working Party has elaborated a working document which states a list of the principles that are considered to be *sine qua non* for personal data protection and that must be present in a third country system to be considered “adequate.”⁴⁸ This document is the basis for the analysis of third countries’ “adequacy” conducted by the European Commission. It has to be noted that this document is a guideline that has not the character of formal law.

46 Article 25(2) of the Directive.

47 See J. Dhont and M.V. Perez Asinari “New Physics and the Law...,” *op. cit.*, pp. 73-79.

48 Article 29 Personal Data Protection Working Party, Working Document Transfers of Personal Data to Third Countries: Applying Articles 25 and 26 of the EU Data Protection Directive,” WP 12, 24 July 1998. The principles enunciated are the following: purpose limitation; data quality and proportionality; transparency; security; rights of access, rectification and opposition; restrictions on onward transfers; additional principles to be applied to specific types of processing: sensitive data, direct marketing, automated individual decisions; procedural and enforcement mechanisms; good level of compliance, support and help to individual data subjects, appropriate redress to the injured party.

“Adequacy” should be understood in a dynamic way, evolving together with the evolution of EU law.⁴⁹

The Directive also foresees a series of exceptions to this general principle:

A. Derogations of Article 26(1)

There are some cases in which a transfer or a set of transfers of personal data to a third country that does not ensure an adequate level of protection can anyway take place. The Directive creates a set of derogations to the general principle, so the transfer will be possible when:

- a) The data subject has given his consent unambiguously to the proposed transfer; or
- b) The transfer is necessary for the performance of a contract between the data subject and the controller or the implementation of pre-contractual measures taken in response to the data subject's request; or
- c) The transfer is necessary for the conclusion or performance of a contract concluded in the interest of the data subject between the controller and a third party; or
- d) The transfer is necessary or legally required on important public interest grounds, or for the establishment, exercise or defence of legal claims; or
- e) The transfer is necessary in order to protect the vital interests of the data subject; or
- f) The transfer is made from a register which according to laws or regulations is intended to provide information to the public and which is open to consultation either by the public in general or by any person who can demonstrate legitimate interest, to the extent that the conditions laid down in law for consultation are fulfilled in the particular case.⁵⁰

B. Adequacy Decisions

If none of the exceptions mentioned above are suitable for the particular typology of transfers to be conducted, there are other possibilities that can be used to make a legitimate transfer. The European Commission can adopt a Decision in order to declare the “adequacy” of a particular

49 For instance, one may think about the influence of Directive 2002/58/EC in the concept of adequacy. Are the solutions of this Directive to the concrete cases regulated a direct application of the general principles of Directive 95/46/EC? Does this new Directive go beyond the general principles imposing new obligations to data controllers? If this were the case, should “adequacy” be analysed on those grounds? In principle, a positive answer to this last question would be the proper approach.

50 Article 26(1) of directive 95/46.

system. The European Commission has issued, so far, seven Decisions under Article 25(6). The "Safe Harbour"⁵¹ has been adopted in this context (see *infra*). It determines that a set of privacy principles and frequently asked questions provide adequate level of protection for personal data transferred from the EU to the US. Decisions have been adopted also concerning Switzerland,⁵² Hungary,⁵³ Canada,⁵⁴ Argentina,⁵⁵ Guernsey,⁵⁶ and concerning the transfer of PNR airline passengers data to the US.⁵⁷

C. Contractual Clauses

There is another alternative way for making a safe transfer as stipulated by Article 25(2) and 25(4). Appropriate contractual clauses can be proposed by the data controller to the Member State Data Protection Authority (DPA) for approval, they can be elaborated by this Authority

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- 51 Commission Decision of 26 July 2000 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequacy of the protection provided by the Safe Harbour privacy principles and related frequently asked questions issued by the US Department of Commerce, OJEC L 215/7, 25/08/2000.
 - 52 Commission Decision of 26 July 2000 pursuant to Directive 95/46/CE of the European Parliament and of the Council on the adequacy of the protection provided in Switzerland. OJEC L 215, 25/08/2000.
 - 53 Commission Decision of 26 July 2000 pursuant to Directive 95/46/CE of the European Parliament and of the Council on the adequacy of the protection provided in Hungary, OJEC L 215, 25/08/2000.
 - 54 Commission Decision of 20 December 2001 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequate protection of personal data provided by the Canadian Personal Information Protection and Electronic Documents Act, OJEC L 2/13, 4/01/2002.
 - 55 Commission Decision of 30 June 2003 pursuant to Directive 95/46/CE of the European Parliament and of the Council on the adequacy of the protection provided in Argentina, OJEC L 168, 5/07/2003.
 - 56 Commission Decision of 21 November 2003 on the adequate protection of personal data in Guernsey, OJEC L 308, 25/11/2003.
 - 57 Commission Decision of 14 May 2004 on the adequate protection of personal data contained in the Passenger Name Record of air passengers transferred to the United States' Bureau of Customs and Border Protection, C(2004) 1914, available at: http://www.europa.eu.int/comm/internal_market/privacy/docs/adequacy/pnr/c-2004-1914/c-2004-1914_en.pdf. On this issue see M.V. Perez Asinari and Y. Poulet "The airline passenger data disclosure case and the EU-US debate," *Computer Law & Security Report*, Vol. 20 no. 2, 2004, pp. 98-116. See also, by the same authors, "Airline passenger's data: adoption of an adequacy Decision by the European Commission. How will the story end?," to be published in *Computer Law & Security Report*. Note that this arena exceeds the sole application of Directive 95/46/EC (a first pillar instrument). In the context of the NTA, the second shared goal "Responding to global challenges" states what follows: "[w]e are determined to take new steps in our common battle against the scourges of international crime, drug trafficking and terrorism." Indeed, the PNR case must be treated, in principle, in the context of both first and third pillar (Public security questions).

as "standard contractual clauses" or even by the European Commission. This is the case of a Commission Decision on standard contractual clauses for the transfer of personal data to third countries (to controllers) under article 26(4) of Directive 95/46/EC⁵⁸ and the Commission Decision on standard contractual clauses for the transfer of personal data to processors established in third countries, under Directive 95/46/EC.⁵⁹ The use of these clauses is voluntary.

The general Directive is complemented by Directive 2002/58/EC,⁶⁰ which regulates the protection of privacy in the electronic communications sector. This instrument provides specific rules for unsolicited electronic communications, traffic data, cookies, etc.

In the EU framework, self-regulation is foreseen⁶¹ as a "complement," bringing "added value"⁶² to state regulation. The Directive foresees that trade associations or other bodies representing other categories of controllers may submit their Codes of Conduct to the Article 29 Data Protection Working Party for an evaluation of compatibility with the Directive.

The Interinstitutional Agreement on better law-making⁶³ concluded recently by the European Parliament, the Council and the Commission adopts the following approach:

16. The three Institutions recall the Community's obligation to legislate only where it is necessary... They recognize the need to use, in suitable cases or where the Treaty does not specifically require the use of a legal instrument, alternative regulations mechanisms.

58 Commission Decision 2001/497/EC of 15 June 2001 on standard contractual clauses for the transfer of personal data to third countries, under Directive 95/46/EC, OJEC L 181/19, 4/07/2001.

59 Commission Decision 2002/16/EC of 27 December 2001 on standard contractual clauses for the transfer of personal data to processors established in third countries, under Directive 95/46/EC.

60 Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications), OJEC L 201, 31/07/2002.

61 Article 27 of the Directive.

62 The Directive insists about the fact that specificities of each sector must be taken into account in the drafting of Codes of Conduct.

63 European Parliament, Council and Commission Interinstitutional Agreement on better law-making, OJEC C 321/1, 31/12/2003.

Notwithstanding, the limit of this approach is determined in the next paragraph:

17. The Commission will ensure that any use of co-regulation or self-regulation is always consistent with Community law and that it meets the criteria of transparency (in particular the publicising of agreements) and representativeness of the general interest. These mechanisms will not be applicable where fundamental rights or important political options are at stake or in situations where the rules must be applied in a uniform fashion in all Member States. They must ensure swift and flexible regulation which does not affect the principles of competition or the unity of the internal market.

This approach reaffirms the orientation of the Directive concerning alternative regulatory means.⁶⁴

B. The US Framework

The US regulatory system is noticeably different to the EU one. It is a sort of "patchwork" of federal and state constitutional law, federal and state statutory law, tort law, and industry self-regulation.⁶⁵ At international level, the US has signed, but not ratified the American Convention on Human Rights⁶⁶ (Pact of San José, Costa Rica), which stipulates the right to privacy in its Article 11.⁶⁷ At national level, the US Constitution does not provide explicitly for a right to privacy. However, it foresees different mechanisms to protect the citizens against state intrusion (but not against private entities).⁶⁸ The US system of privacy and personal data protection is characterized, then, by fragmentation. There is no general framework covering every sector (private and public, as is the case of the Directive, or Convention no. 108) creating general rights, obligations and the figure of an independent authority

64 For a broader discussion see: Y Poullet, "ICT and Regulation...", op. cit.

65 See: P. Schwartz and J. Reidenberg, *Data Privacy Law. A Study of United States Data Protection*, Michie Law Publishers, Virginia, 1996. J. Dhont and M.V. Perez Asinari "New Physics and the Law...", op. cit. Electronic Privacy Information Center and Privacy International, *Privacy & Human Rights*, USA, 2003.

66 Convención Americana sobre Derechos Humanos, Pacto de San José de Costa Rica, 7 al 22 de noviembre de 1969. Available at: <http://www.oas.org/juridico/spanish/tratados/b-32.html>. This Convention has been adopted in the context of the Organization of American States (OAS), and it has been ratified by all the Latin American countries, see: <http://www.oas.org/juridico/spanish/firmas/b-32.html>.

67 Article 11. Right to Privacy: "1. Everyone has the right to have his honor respected and his dignity recognized. 2. No one may be the object of arbitrary or abusive interference with his private life, his family, his home, or his correspondence, or of unlawful attacks on his honor or reputation. 3. Everyone has the right to the protection of the law against such interference or attacks."

68 "Most of the private sector's data processing will not be subject to constitutional constraints" P. Schwartz and J. Reidenberg, *Data Privacy Law. Law...*, op. cit., p. 31.

(analogue to the European national DPAs). Indeed, the US has not translated internally the trend created by the OECD Guidelines.

Reidenberg and Schwartz underline that:

[C]onstitutional rights in the United States forbid government from doing certain things in a certain fashion, but usually do not require the state to take action. The Constitution does not compel the government to create data protection that allocates the burdens and benefits of the state's information use.⁶⁹

The authors identify four critical areas of US Constitutional law of Data Protection:⁷⁰ (1) associational privacy; (2) voting rights; (3) the Fourth Amendment's protection against search and seizure; (4) informational privacy

They analyse these areas *vis-à-vis* four elements of the European approach⁷¹ to data protection searching for functional similarity. It is summarized, then, that:

[T]he first two areas of constitutional law, associational privacy and voting rights, are directly related to deliberative democracy. The state's application of personal information regarding group affiliation and exercise of the franchise can harm individual participation in political self-government. Fairly strong constitutional protections exist in these two areas. As for the Fourth Amendment's protection from unreasonable searches and seizures and the Fifth and Fourteenth Amendment's creation of a right of informational privacy, these areas of constitutional law concern deliberative autonomy, or the impact of the state's collection and application of personal information on the individual's ability to make decisions in deciding how to live her life. Here, the Supreme Court's definition and application of these constitutional rights have provided less than satisfactory protection.⁷²

Many specific laws have been adopted both for the public and private sector, such as: Fair Credit Reporting Act (1970), Fair Credit Billing Act (1974), Privacy Act (1974), Equal Credit Opportunity Act (1974), Right to Financial Privacy Act (1978), Computer Matching Act (1988), Video Privacy Act (1988), Electronic Communications and Privacy Act (1986), Cable Communications Policy Act (1984), Telephone Consumer Protection Act(1991), Health Insurance Portability and Accountability Act—HIPPA—(1996), Children's Online Privacy Protection

69 P. Schwartz and J. Reidenberg, *Data Privacy Law...*, op. cit., p. 31.

70 P. Schwartz and J. Reidenberg, *Data Privacy Law...*, op. cit., p. 36.

71 The four elements have been schematised as follows: "(a) the establishment of obligations and responsibilities for personal information; (b) the maintenance of transparent processing of personal information; (c) the creation of special protection for sensitive data; and, (d) the establishment of enforcement rights and effective oversight of the treatment of personal information." P. Schwartz and J. Reidenberg, *Data Privacy Law...*, op. cit., p. 13.

72 P. Schwartz and J. Reidenberg, *Data Privacy Law...*, op. cit., p. 43-44.

Act—COPPA—(1998), Can Spam Act (2003), etc. It has to be noted that this regulatory model leaves certain sectors unregulated.⁷³

Further to this, the *Restatement (Second) of Torts*⁷⁴ has classified privacy torts as follows: (1) intrusion upon seclusion; (2) public disclosure of private facts; (3) false light privacy; and (4) misappropriation of name or likeness for commercial purposes. It has to be noted that, whereas in the EU data subjects can theoretically introduce a tort law action in case of any personal data protection legislation infringement that results in physical or moral damage, US tort law in the privacy arena is limited to the cases mentioned.⁷⁵ Whilst the application of US privacy torts in the digital sphere remain dubious, Annex IV to the Safe Harbour Decision contains an answer to the European Commission's request for clarification of US law with respect to claims for damages for breaches of privacy:

In the context of the safe harbour framework, 'intrusion upon seclusion' could encompass the unauthorized collection of personal information whereas the unauthorized use of personal information for commercial purposes could give rise to a claim of appropriation. Similarly, the disclosure of personal information that is standard of being *highly offensive to a reasonable person*. Finally, the invasion of privacy that results from the publication or disclosure of *sensitive personal information* could give rise to a cause of action for "publication of private facts".⁷⁶

As far as the particular field of e-commerce is concerned,⁷⁷ the White House issued a political document, during Clinton administration, giving guidelines for the regulatory approach.⁷⁸ The document develops the following statements: (1) the private sector should lead, (2) Governments should avoid undue restrictions on electronic commerce, (3) where governmental involvement is needed, its aim should be to support and enforce a predictable, minimalist, consistent and simple legal environment for commerce, (4) governments should recognize the unique qualities of the Internet, and (5) electronic commerce over the Internet should be facilitated on a global basis. In what concerns privacy it applies the same principles, being in line with the general philosophy of the paper:

73 See: See J. Dhont and M.V. Perez Asinari "New Physics and the Law...", op. cit., pp. 84-89.

74 Restatement of the Law Second, Torts 2d, § 652, Division St Paul, Minn., American Law Institute Publishers, 1977, pp. 376-403.

75 J. Dhont and M.V. Perez Asinari "New Physics and the Law...", op. cit., p. 89.

76 Italics added. We see that, even in the off-line world the application of these torts is quite restrictive.

77 See: J. Reidenberg, "Restoring Americans' Privacy in Electronic Commerce," 14 Berkeley Tech. L. J., 1999, pp. 771 and ss.

78 The White House, A Framework for Global Electronic Commerce, 1 July 1997, available at: <http://www.nyls.edu/cmcpapers/whgiiifra.htm>, last visited 31/05/04.

[T]he Administration considers data protection critically important. We believe that private efforts of industry working in cooperation with consumer groups are preferable to government regulation, but if effective privacy protection cannot be provided in this way, we will re-evaluate this policy.⁷⁹

So far, the federal government has considered the e-market regulatory failure, in what concerns the protection of on-line children's privacy, what derived in the adoption of COPPA. Apart from that, even if, in a certain moment the Federal Trade Commission has pointed out the necessity to adopt legislation to protect consumer privacy on the Internet,⁸⁰ the FTC chairman referred that more study was necessary before the adoption of legislation in this field.⁸¹

That being the case, self-regulation is the US choice for the protection of privacy and personal data in the e-commerce context. There is a burden in the data subject's side, she has to check what is the level of privacy each of her digital interlocutor offers. Protection is not provided by default. There is no legal obligation to provide protection, unless the US data controller (a website administrator, the company representative, or the person/body with legal capacity to oblige the company) has represented to guarantee it. Then, if there is a misrepresentation, the data subject (the "consumer" in the US conception) can sue for "unfair and deceptive" practice under the FTC Act.⁸² The industry has then self-regulated via the adoption of privacy policies posted on their websites, codes of conduct, adhesion to privacy networks (such as NAI⁸³ or OPA),⁸⁴ adoption of labelling systems (such as TRUSTe⁸⁵ or BBBonline,⁸⁶ etc.).

Certain significant problems, which indeed are not circumscribed to the US in their effects, have come to surface in the digital world:

Internet privacy has remained the hottest issue of the past few years. Several profitable companies, including eBay.com, Amazon.com,

79 *Ibidem*.

80 Privacy Online: Fair Information Practices in the Electronic Marketplace: A Federal Trade Commission Report to Congress (May 2000), available at: <http://www.ftc.gov/reports/privacy2000/privacy2000.pdf>, last visited 07/06/04.

81 Protecting Consumers' Privacy: 2002 and Beyond, Remarks of FTC Chairman Timothy J. Muris, October 2001, available at: <http://www.cdionline.org/mediaroomdocs/ACF3194.pdf>, last visited 07/06/04.

82 Federal Trade Commission Act. 15 USC §§ 41-58, as amended. Section 5 of the FTC Act prohibits unfair or deceptive acts or practices in the marketplace.

83 Network Advertising Initiative, see: <http://www.networkadvertising.org/>, last visited 31/05/04.

84 Online Privacy Alliance, see: <http://www.privacyalliance.org/>, last visited 31/05/04.

85 See: <http://www.truste.org/>, last visited 31/05/04.

86 See: <http://www.bbbonline.org/>, last visited 31/05/04.

drkoop.com, and Yahoo.com have either changed users' privacy settings or have changed privacy policy to the detriment of users. A series of companies, including Intel and Microsoft, were discovered to have released products that secretly track the activities of Internet users. Users have filed several lawsuits under the wiretap and computer crime laws. In several cases, TRUSTe, an industry-sponsored self-regulation watchdog group, ruled that the practises did not violate its privacy seal program. Significant controversy arose around online profiling, the practice of advertising companies to track Internet users and compile dossiers on them in order o target banner advertisements. The largest of these advertisers, DoubleClick, ignited widespread public outrage when it began attaching personal information from a marketing firm it purchased to the estimated 100 million previously anonymous profiles it had collected...⁸⁷

One of the issues that has been creating a major concern is the question of unsolicited commercial e-mails or unsolicited bulk e-mails (generally known as "spam"). The CAN-SPAM Act of 2003⁸⁸ has been adopted to tackle this problem. Indeed, this topic can serve as another example to show the different conceptions. Whereas, in Europe, this is an issue that is regulated by privacy laws,⁸⁹ in the US, this recent Act does not make reference to privacy or personal data protection, but mainly to the monetary costs implications for recipients and Internet Access providers.

Interestingly, this US law has extraterritorial application. For instance, it punishes whoever:

[A]ccesses to a *protected computer* without authorization, and intentionally initiates the transmission of multiple commercial electronic mail messages from or through such computer;⁹⁰ [or]

[U]ses a *protected computer* to relay or retransmit multiple commercial electronic mail messages, with the intent to deceive or mislead recipients, or any Internet access service, as the origin of such messages.⁹¹

87 Electronic Privacy Information Center and Privacy International, *Privacy & Human Rights*, op. cit., p. 530.

88 Public Law 108-187, 108th Congress, An Act to regulate interstate commerce by imposing limitations and penalties on the transmission of unsolicited commercial electronic mail via the Internet. 16 December 2003 [S. 877], available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=108_cong_public_laws&docid=f:publ187.108.pdf.

89 Directive 2002/58/EC.

90 Sec. 4(a)(1), emphasis added.

91 Sec. 4(a)(1), emphasis added.

A “protected computer” is defined as a computer:

[W]hich is used in interstate or foreign commerce or communication, including a computer located outside the United States that is used in a manner that affects interstate or foreign commerce or communications of the United States.⁹²

Apart from that, Section 12, “Restrictions on other transmissions,” stipulates another extraterritorial application:

Section 227(b)(1) of the Communications Act of 1934 (47 USC 227[b][1]) is amended, in the matter preceding subparagraph (A), by inserting “or any person outside the United States if the recipient is within the United States”, after “United States”.

Conscious of the factual limits of a national law in this domain, the Act acknowledges, in the Section dedicated to the “Congressional findings and policy,” that:

The problems associated with the rapid growth and abuse of unsolicited commercial electronic mail cannot be solved by Federal legislation alone. The development and adoption of technological approaches and the pursuit of cooperative efforts with other countries will be necessary as well.⁹³

IV. Have There Been Efforts of Joint Governance?

When Directive 95/46/EC came into force, certain scholars predicted a sort of catastrophe or trade war in case Article 25(1) of the Directive was enforced.⁹⁴ A US civil servant has even declared that such a European regulation would be challenged at the WTO.⁹⁵

⁹² Sec. 3(13).

⁹³ Sec. 2(12).

⁹⁴ P. Swire and R. Litan, *None of your Business*. World Data Flows, Electronic Commerce, and the European Privacy Directive, Brookings Institution Press, Washington DC, 1998, p. 44.

⁹⁵ Ira Magaziner—former responsible person for US discussions on e-commerce—has declared that she would “challenge EU privacy rules under the theory that they represent barriers to trade,” see “Notes from the OECD Ministerial Meeting on Electronic Commerce” at Ottawa, Ontario, Canada, October 9, 1998, J. LOVE, Consumer Project on Technology, available at: <http://www.cptech.org/ecom/ottawa.html>, last visited 31/05/04. Some authors have also referred to that possibility: P. Swire and R. Litan, *None of your Business...*, op. cit., p. 188-196. L Bergkamp “The Privacy Fallacy: Adverse Effects of Europe’s Data Protection Policy in an Information-Driven Economy,” *Computer Law & Security Report*, vol. 18 no. 1, 2002, pp. 39-40. For another view see: G. Shaffer “Globalization and Social Protection...,” op. cit. G. Shaffer “Managing US-EU Trade Relations through Mutual Recognition and Safe Harbor Agreements: “New” and “Global” Approaches to Transatlantic Economic Governance?,” EUI Working Papers, RSC No. 2002/28, Robert Schuman Centre, 2002, available at:

Clearly, a solution was required. A negotiation process started, then, based on a set of SH Principles and Frequently Asked Questions (FAQs) elaborated by the US Department of Commerce (DoC) jointly with representatives from the private sector. The reasons for the adoption of the SH could be summarized as follows:

- It was clear that the US system could not be considered “adequate” from the EU perspective. Lacunas arise from the different fragments of US regulation. Even in those sectors regulated by statutory law, personal data of EU origin is not always granted the protection described in the Working Document no. 12 (for instance, the Privacy Act is only applicable to “citizen[s] of the United States or an alien lawfully admitted for permanent residence”).⁹⁶ The self-regulatory approach, as such, did not give evidence of covering all the “adequacy” principles.
- The Hungarian and Swiss models were not suitable for an adequacy Decision for the US. Those countries do have general data protection systems and they are both signatories of the Convention no. 108.
- Beyond the Directive, Member States have a positive obligation to safeguard the protection of fundamental rights.⁹⁷
- However, the flow of personal data is necessary from an economic point of view: there are many economic sectors that conduct trans-border data flows from the EU to the US. Moreover, the EU had assumed political

(contd.)

http://cadmus.iue.it/dspace/retrieve/1606/02_28.pdf. M.V. Perez Asinari “Is there any Room for Privacy and Data Protection within the WTO Rules?,” *Electronic Communications Law Review*, vol. 9, 2003, pp. 249-280. M.V. Perez Asinari “The WTO and the Protection of Personal Data. Do EU Measures Fall within GATS Exception? Which Future for Data Protection within the WTO e-Commerce Context?,” BILETA Conference, Controlling Information in the Online Environment, Institute of Computer & Communications law, Queen Mary, University of London, 14-15 April 2003, available at: <http://www.bileta.ac.uk/03papers/perez.html>.

- 96 The Privacy Act of 1974, 5 USC. § 552a (it regulates records handling by Federal, State or local government agencies).
- 97 D. Yemault “L’efficacité de la Convention Européenne des Droits de l’homme pour contester le système ‘Échelon’,” in *Rapport sur l’existence éventuelle d’un réseau d’interception des communications, nommé ‘Échelon’,* Sénat et Chambre des Représentants de Belgique, 25 février 2002. In this article, the author studies the nature of the ECIIR: 1) as an instrument guaranteeing “European public order,” considered as a coherent whole, in the sense that it was qualified by the Strasbourg Court in 1995; 2) as an international treaty that gives place to the State’s international liability; and 3) as an international treaty of a particular nature, due to its Article 53, by virtue of which adherent States recognise its legal pre-eminence over any other internal or international regulation that would be less protective of Fundamental Rights than the Convention itself. See also: Y. Poullet “Le droit et le devoir de l’Union européenne et des états membres de veiller au respect de la protection des données dans le commerce mondial,” in *The Spanish Constitution in the European Constitutional Context*, ed. F. Fernandez Segado, Dykinson SL, Madrid, 2003, pp. 1753-1772.

compromises, with the US, by the adoption of the NTA, and also legal compromises at the WTO⁹⁸ (and even if privacy is foreseen as an exception to the application of the GATS⁹⁹ rules, for this exception to proceed certain requisites must be respected).¹⁰⁰

After more than two years of negotiations between the US Department of Commerce and the European Commission, the Safe Harbour Decision was issued on the basis of Article 25(6) of the Directive. In the meantime, the industry played an active role expressing its position in this regard, the Article 29 Data Protection Working Party elaborated many Opinions¹⁰¹ on the level of "adequacy" that the Principles and FAQs represented pointing out certain flaws, and the European Parliament questioned and seriously criticized the (draft) SH Decision.¹⁰²

98 For studies about WTO implications see: G. Shaffer "Globalization and Social Protection..." op. cit. G. Shaffer "Managing US-EU Trade Relations through Mutual Recognition and Safe Harbor Agreements..." op. cit. M.V. Perez Asinari "Is there any Room for..." op. cit. M.V. Perez Asinari "The WTO and the Protection of Personal Data..." op. cit.

99 General Agreement on Trade in Services, available at: http://www.wto.org/english/tratop_e/serv_e/2-obdis_e.htm.

100 Article XIV: "General Exceptions: Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures: (a) necessary to protect public morals or to maintain public order; (b) necessary to protect human, animal or plant life or health; (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to: (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts; (ii) *the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts* [emphasis added]; (iii) safety..."

101 See Article 29 Personal Data Protection Working Party: Opinion 1/99 concerning the level of data protection in the United States and the ongoing discussions between the European Commission and the United States Government, WP 15, 26 January 1999; Opinion 2/99 on the adequacy of the "International Safe Harbor Principles" issued by the US Department of Commerce on 19 April 1999, WP 19, 3 May 1999; Opinion 4/99 on the frequently asked questions to be issued by the US Department of Commerce to the proposed "Safe Harbor Principles," WP 21, 7 June 1999; Working Document on the current state of play of the ongoing discussions between the European Commission and the United States Government concerning the "International Safe Harbor Principles," WP 23, 7 July 1999; Opinion 7/99 on the level of data protection provided by the "Safe Harbor Principles" as published together with the Frequently Asked Questions (FAQs) and other related documents on 15 and 16 November 1999 by the US Department of Commerce, WP 27, 3 December 1999; Opinion 3/2000 on the EU/US dialogue concerning the "SH" arrangement, WP 31, 16 March 2000; Opinion 4/2000 on the level of protection provided by the "Safe Harbor Principles," WP 32, 16 May 2000.

102 European Parliament resolution on the Draft Commission Decision on the adequacy of the protection provided by the Safe Harbour Privacy Principles and related Frequently Asked

However, as we will see below, the SH was a very punctual effort. It tries to find an exception to the application of Article 25(1) of the Directive, but its application is quite restrictive.

A. Characteristics of the Safe Harbour

The "Safe Harbour"¹⁰³ (SH) is not an "Agreement" from a Public International law or European Community law perspective.¹⁰⁴ It is a Decision,¹⁰⁵ adopted unilaterally by the European Commission, declaring that the Principles and FAQs annexed therein are considered to ensure an "adequate level of protection."

US organizations adherence to the SH is voluntary. However, if they self-certify to the US Department of Commerce their adherence they are bound by this commitment. They are obliged, then, to comply with the Principles and FAQs to retain the benefits of the SH and to publicly represent that they do so, normally in the form of "Privacy Policies." The SH applies only to sectors which fall under the jurisdiction of the Federal Trade Commission (FTC) or the US Department of Transportation (DoT).¹⁰⁶ As a consequence, important economic sectors, such as banks, insurance or telecommunications are excluded from the SH framework. Moreover, even if the SH scheme refers explicitly to the human resources data, the jurisdiction of the FTC in this field remains dubious.¹⁰⁷ Then, a US organization can

(contd.)

Questions issued by the US Department of Commerce (C5-0280/2000 - 2000/2144[COS]). OJEC C 121/155, 24/04/2001.

103 See generally J. Reidenberg, "Privacy Wrongs in Search of Remedies," *Hastings Law Journal*, 2003, vol. 54, pp. 877-898. J. Reidenberg, "E-Commerce and Trans-Atlantic Privacy," *Houston Law Review*, 2001, vol. 38, pp. 717-749. Y. Poulet, "The Safe Harbor Principles—An Adequate Protection?," paper presented at International Colloquium organized by IFCLA, Paris, 15-16 June 2000, available at: <http://www.droit.fundp.ac.be/textes/safeharbor.pdf>, last visited 28 February 2004. See also the report prepared in the context of the Safe Harbour revision: J. Dhont, M.V. Perez Asinari and Y. Poulet, with the collaboration of J. Reidenberg and L. Bygrave, *Safe Harbour Decision Implementation Study*, at the request of the European Commission, Internal Market DG, Contract PRS/2003/A0-7002/E/27, not publicly available yet, to be published in DG MARKT website, Data Protection Unit.

104 When the European Parliament issued its resolution on the draft Commission SH Decision it pointed out: "3. Draws the Commission's attention to the risk that the exchange of letters between the Commission and the US Department of Commerce on the implementation of the "safe harbour" principles could be interpreted by the European and/or United States judicial authorities as having the substance of an international agreement adopted in breach of Article 300 of the Treaty establishing the European Community and the requirement to seek Parliament's assent (Judgment of the Court of Justice of 9 August 1994: French Republic v. the Commission—Agreement between the Commission and the United States regarding the application of their competition laws [Case C-327/91])."

105 Decisions are one of the sources of Community law. Article 249 TEC, 4th paragraph.

106 Recital 6 of the Commission Decision.

107 See J. Reidenberg "E-commerce and Transatlantic Privacy," *op. cit.*, p. 743.

qualify for the SH only if its failure to comply with its commitment to adhere to the SH principles is actionable under the Federal Trade Commission Act section 5 (prohibiting unfair and deceptive acts) or Title 49 United States Code (USC) section 41712. A deceptive practice is defined as a "representation, omission or practice that is likely to mislead reasonable consumers in a material fashion."¹⁰⁸

The SH Privacy Principles are the following:

- **NOTICE:**

An organization must inform individuals about the purposes for which it collects and uses information about them, how to contact the organization with any inquiries or complaints, the types of third parties to which it discloses the information, and the choices and means the organization offers individuals for limiting its use and disclosure. This notice must be provided in clear and conspicuous language when individuals are first asked to provide personal information to the organization or as soon thereafter as is practicable, but in any event before the organization uses such information for a purpose other than that for which it was originally collected or processed by the transferring organization or discloses it for the first time to a third party.

- **CHOICE:**

An organization must offer individuals the opportunity to choose (opt out) whether their personal information is (a) to be disclosed to a third party or (b) to be used for a purpose that is incompatible with the purpose(s) for which it was originally collected or subsequently authorized by the individual. Individuals must be provided with clear and conspicuous, readily available, and affordable mechanisms to exercise choice.

For sensitive information (i.e. personal information specifying medical or health conditions, racial or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership or information specifying the sex life of the individual), they must be given affirmative or explicit (opt in) choice if the information is to be disclosed to a third party or used for a purpose other than those for which it was originally collected or subsequently authorized by the individual through the exercise of opt in choice. In any case, an organization should treat as sensitive any information received from a third party where the third party identifies and treats it as sensitive.

¹⁰⁸ A practice is unfair if it causes, or is likely to cause, substantial injury to consumers which is not reasonably avoidable and is not outweighed by countervailing benefits to consumers or competition: see 15 USC section 45(n) and letter of 14 July 2000 from FTC Chairman Mr. Robert Pitofsky to Mr. John Mogg, Director, DG XV, European Commission (set out in the Commission Decision, Annex V).

- **ONWARD TRANSFER:**

To disclose information to a third party, organizations must apply the Notice and Choice Principles. Where an organization wishes to transfer information to a third party that is acting as an agent, as described in the endnote, it may do so if it first either ascertains that the third party subscribes to the Principles or is subject to the Directive or another adequacy finding or enters into a written agreement with such third party requiring that the third party provide at least the same level of privacy protection as is required by the relevant Principles. If the organization complies with these requirements, it shall not be held responsible (unless the organization agrees otherwise) when a third party to which it transfers such information processes it in a way contrary to any restrictions or representations, unless the organization knew or should have known the third party would process it in such a contrary way and the organization has not taken reasonable steps to prevent or stop such processing.

- **SECURITY:**

Organizations creating, maintaining, using or disseminating personal information must take reasonable precautions to protect it from loss, misuse and unauthorized access, disclosure, alteration and destruction.

- **DATA INTEGRITY:**

Consistent with the Principles, personal information must be relevant for the purposes for which it is to be used. An organization may not process personal information in a way that is incompatible with the purposes for which it has been collected or subsequently authorized by the individual. To the extent necessary for those purposes, an organization should take reasonable steps to ensure that data is reliable for its intended use, accurate, complete, and current.

- **ACCESS:**

Individuals must have access to personal information about them that an organization holds and be able to correct, amend, or delete that information where it is inaccurate, except where the burden or expense of providing access would be disproportionate to the risks to the individual's privacy in the case in question, or where the rights of persons other than the individual would be violated.

- **ENFORCEMENT:**

Effective privacy protection must include mechanisms for assuring compliance with the Principles, recourse for individuals to whom the data relate affected by non-compliance with the Principles, and consequences for the organization when the Principles are not followed. At a minimum, such mechanisms must include (a) readily available and affordable independent recourse mechanisms by which each individual's complaints and disputes are investigated and resolved by reference to the Principles

and damages awarded where the applicable law or private sector initiatives so provide; (b) follow up procedures for verifying that the attestations and assertions businesses make about their privacy practices are true and that privacy practices have been implemented as presented; and (c) obligations to remedy problems arising out of failure to comply with the Principles by organizations announcing their adherence to them and consequences for such organizations. Sanctions must be sufficiently rigorous to ensure compliance by organizations.

Furthermore, the 15 FAQs intend to provide clarification in certain key issues, such as sensitive data, the journalistic exceptions, the role of national DPAs, self-certification, verification, dispute resolution and enforcement, etc.

B. Implementation of the Safe Harbour in Practise and Beyond

Since the adoption of the SH Decision 508¹⁰⁹ companies have adhered. It is not possible to state, *a priori*, if such a number represents a successful story or not. To make an evaluation, it would be necessary to know how many companies conduct flows of personal data from the EU to the US that are not covered by the exceptions of Article 26(1), appropriate or standard contractual clauses, or any other alternative method considered "adequate" by a national DPA.

So far, there has not been any complaint from a data subject or DPA as a consequence of a violation to the SH by a US organization. One could then deduce that the implementation is correct and that all the obligations and rights foreseen in the SH scheme are fully respected by US organizations. Nevertheless, an analysis of the privacy policies content, or even the lack of publicly available privacy policies in certain cases, could demonstrate, to a given extent, the contrary. For instance, if we have a look at the SH list posted on the DoC website,¹¹⁰ we will find cases where a direct access to the privacy policy is not possible. On the contrary, a hyperlink will lead us to the homepage of the US organization that has self-certified to the SH. When at this webpage, it is sometimes difficult to find the link to the privacy policy. After having reached the privacy policy, its terms may be not very clear, or the SH principles may not be all represented. Should we understand that if there is no representation of a SH principle there is no obligation *vis-à-vis* a European data subject? This remains unclear.

Whereas in the EU, the legitimacy of processing activities is structured around the concept of "purpose," the purpose is usually difficult to find in SH privacy policies. Moreover, the DoC self-certification page does not foresee any entry for this specification to be made. This is just another example of the kind of problems that can be found in the implementation practise.

109 As of 8/06/04. Check: <http://web.ita.doc.gov/safeharbor/shlist.nsf/webPages/safe+harbor+list>.

110 <http://www.export.gov/safeharbor/>.

The enforcement mechanisms may present other kind of difficulties, for instance, the sanctions to which US organizations would be subject, if they violate the SH principles, are not always specified in the privacy policies or privacy programmes. The same could be said concerning remedies or the obligation to reverse the effects of breach.

One may wonder, then, if the EU data subject is aware of the transfer of her data to the US, and if so, to what extent she is conscious of the rights foreseen in the SH to protect her against illegitimate processing. One may wonder, also, if US organizations that give evidence of good will by adhering to the SH and that make efforts and invest in the implementation of it into its business practises have a full understanding of a system that is quite different from the one they are used to apply. We could say that, in principle, efforts remain to be made for a full implementation of the SH scheme.

Beyond the SH, we have to (re)consider the scope of EU-US transatlantic cooperation broadly. The SH is just a first step to reach the goals described in the joint political documents. We have seen that its scope of application is restrictive. However, there have not been further efforts to enlarge its scope (at least no official negotiations have started).

C. Have There Been Impediments for a Successful Cooperation?

What would be “successful cooperation” in this field? From the perspective of the NTA and the related political documents we have considered, it would be the creation of a legal framework for the effective protection of privacy and personal data that can contribute to the expansion of world trade and closer economic relations.

The SH is, indeed, a fragmented solution both within the framework of the Directive scope of application and the framework of the NTA. It covers only certain economic sectors and within these sectors only the US organizations that self-certify their adherence to the principles. Furthermore, it is limited to the US, not giving an answer to the organizations that work on a multinational basis.¹¹¹ We may even wonder if it is a case of “joint governance” or just a unilateral instrument to solve, partly, a legal problem. Thus, the scope of cooperation beyond the SH has been quite limited.

The impediments are rather intrinsic. Privacy is a subject matter that has been regulated differently by both parties, however, certain degree of understanding on common legally-binding standards would benefit the development of the

111 See: Article 29 Personal Data Protection Working Party, Working Document on Transfers of personal data to third countries: Applying Article 26 (2) of the EU Data Protection Directive to Binding Corporate Rules for International Data Transfers, WP74, 3 June 2003.

Information Society in general, and of electronic commerce in particular. Here, we are not strictly speaking about trans-border data flows that fall into the Directive's scope of application. The normal use of open networks involves many activities that do not imply the application of Directive 95/46/EC (neither of Article 4.1[c],¹¹² nor of Article 25[1]).

Could this be the case, for instance, of a simple operation of e-commerce? The buyer (data subject) is located in the EU. The seller (data controller) is located in the US. The seller needs the data subject's personal data to be able to deliver the product. She decides the means and purposes of the processing activity, but, as she is not located in the EU, and she is not making use of equipment located in the EU to process personal data, she is not subject to Directive 95/46/EC.

However, even if the Directive is not applicable, there is a transatlantic political interest that this data be processed in legitimate terms and respecting certain rights of this data subject. If she realizes, for instance, that after the e-commerce operation she starts receiving a lot of unsolicited commercial e-mails she will suspect that her data has been shared or sold. Her consent has not been asked for such use. She reads again the privacy policy posted on the e-commerce site and realizes that the seller has neither made any representation about third parties data sharing, nor about the right of access. As a consequence, the data subject cannot sue the seller under the FTC Act. Even if the privacy policy would have made these kind of representations, it will be for the European data subject to scrutinize the content of this privacy policy and to introduce her complaint before a US Court, or before an unknown ADR located in the US, functioning under unusual rules and in a language that is not the one of the European data subject. This individual would be more than disappointed with this transatlantic experience.

The US self-regulatory approach may not give the EU data subject the protection to which she is used to. This can affect, indeed, a more active participation in e-commerce. Even if, in the case of the example, she has decided to provide her data, and this data is necessary for the performance of the contract, she would not like that data to be used for incompatible purposes, sold and integrated into an indeterminate number of different data bases to profile her, considering the type of good she has bought, etc.

112 National law applicable: "1. Each Member State shall apply the national provisions it adopts pursuant to this Directive to the processing of personal data where: [...] (c) the controller is not established on Community territory and, for purposes of processing personal data makes use of equipment, automated or otherwise, situated on the territory of the said Member State, unless such equipment is used only for purposes of transit through the territory of the Community; 2. In the circumstances referred to in paragraph 1 (c), the controller must designate a representative established in the territory of that Member State, without prejudice to legal actions which could be initiated against the controller himself."

“Impediments” for cooperation arise because the protection of privacy and personal data is fostered through different mechanisms by both parties. Indeed, a solution “in the middle” is quite difficult to be reached. Could we blame the EU for not diminishing the protection deserved by a human right? Could we blame the US for not adopting a general privacy law when their national approach to most e-commerce related matters (including privacy) is market-lead? The SH could be seen as this kind of solution “in the middle.” Yet, is it desired to continue in this line, for example, extending the SH to the banking sector? Or, should negotiation stand beyond the Directive and consider that what could be affecting the development of e-commerce and global digital trade are cases that may fall outside the Directive? Could we say that “impediments” for cooperation can be found in the narrow-Article 25(1)-oriented base of negotiation for transatlantic privacy?

D. Institutions and Practises for Overcoming Obstacles

The negotiation of the SH has been actively conducted between the European Commission and the US Department of Commerce. Other organisations and bodies have supported those institutions. For instance, the Article 29 Data Protection Working Party¹¹³ has closely followed the evolution of the draft principles and FAQs, guiding the Commission for the achievement of a legitimate framework. The private sector has also participated in this process. Those institutions are to be called again for the improvement of SH implementation.

Within the SH framework, the practise that have been used to overcome the obstacles experienced was the use of co-regulation techniques. The SH principles have been elaborated jointly by the public and the private sector.

E. Future Steps

Some of the future steps that the US and the EU might undertake, to strengthen cooperation and attain their common NTA goals, can be summarized as follows:

- a) In the near future,
 - Rectify the errors in the implementation of the SH;
 - Clarify SH concepts that remain unclear, bearing in mind, that they will be applied by US organizations that are not familiar with the EU Directive;
 - Increase EU data subjects and US data controllers awareness of their respective rights and obligations under the SH, a task that has to be conducted by all the institutions with responsibilities and interests in the correct application of this scheme;

113 See footnote 101.

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- Grant an increasing role and visibility to the SH European Panel¹¹⁴ in order to assist the European data subjects in addressing their complaints;
- Clarify the statutes and competences of the ADR bodies.

b) In mid term,

- Enlarge the scope of application of the SH, to cover all the sectors involved in trans-border data flows

Beyond the SH, a closer regard to Privacy Enhancing Technologies (PETs) and the role of technical standards organizations (W3C, IETF,¹¹⁵ ISO, CEN, etc.) has to be encouraged, bearing in mind that they are a "complement" to traditional regulatory choices.¹¹⁶

Moreover, the adoption of sector specific codes of conduct would motivate the active intervention and compromise of the stakeholders involved. At European level, the Federation of European Direct Marketing (FEDMA) Code of Conduct¹¹⁷ could be an example of that trend.¹¹⁸ Further development of Binding Corporate Rules initiatives would be helpful for multinational companies' need.¹¹⁹

c) In a longer term,

- Signature of an International Agreement containing harmonized personal data protection rules.

Again in the formula "beyond the SH," an international Agreement seems to be a natural recourse to harmonize divergent regulations for a common understanding. However, what would be the framework for such an Agreement? A bilateral

114 See FAQ 5 and 11 of the SH. The website of the Secretariat of the SH Panel is: <http://forum.europa.eu.int/Public/irc/secureida/safeharbor/home>.

115 For a description of roles of the W3C (World Wide Web Consortium) and the IETF (Internet Engineering Task Force) see: J. Berleur and Y. Pouillet "Quelles régulations pour l'internet?," in *Gouvernance de la Société de l'Information*, op. cit.

116 See: J. Reidenberg "Lex Informatica: The Formulation of Information Policy Rules through Technology," 76 *Texas L. Rev.*, 1998, pp. 553-584. L. Lessig, *Code and other laws of Cyberspace*, Basic Books, 1999. J. Reidenberg, "States and Internet Enforcement," *Ottawa Journal on Law & Technology*, Vol. 1 Issue 1, 2004, pp. 1-25. P. Schwartz "Beyond Lessig's Code for Internet Privacy: Cyberspace Filters, Privacy-Control, and Fair Information Practices," *Wisconsin Law Review*, 2000, p. 743-788.

117 European Code of Practice for the Use of Personal Data in Direct Marketing, available at: www.europa.eu.int/comm/internal_market/privacy/docs/wpdocs2003/wp77-annex_en.pdf.

118 See: Article 29 Personal Data Protection Working Party, Opinion 3/2003 on the European code of conduct of FEDMA for the use of personal data in direct marketing, WP77, 13 June 2003.

119 See: Article 29 Personal Data Protection Working Party, Working Document on Transfers of personal data to third countries: Applying Article 26 (2) of the EU Data Protection Directive to Binding Corporate Rules for International Data Transfers, WP74, 3 June 2003.

instrument seems insufficient. Which international organization would be then called to assume responsibility and act proactively?

The OECD has a restricted membership, and its efforts, even if innovative when adopted, are not being used to solve concrete problems as the ones described herein, because of the "soft law" nature of the Guidelines. The WTO has considered, so far, privacy and data protection as an exception to its rules. Whilst the Doha agenda had foreseen these issues in the context of the e-commerce discussion, no visible result has derived from Cancun in this realm. It is true that the topic will have to be faced, sooner or later, at the WTO. But this will imply another political discussion and choice, including, to what extent the WTO has jurisdiction in a matter that, at least for some members, is a question of human rights? Or, to what extent countries are willing to enlarge WTO competences in this direction? Would they be obliged to do so, not to leave people without human rights protection when a case involving them is decided in this international sphere?¹²⁰

It has to be underlined that an integral approach to privacy is preferable, that is, not considered only as a "barrier" to trade that can be accepted under certain circumstances. Precisely for this reason, the intervention of the UN would be preferable, insofar this institution has to envisage all aspects of the global society not only the economic but also the cultural, social and human rights ones. The UN could be a discussion and decision-making body to be taken more into account, as a way to solve privacy and personal data protection implications of global networks. The UN has adopted the 1990 Guidelines on computerized personal data files. This document reflects broadly accepted fair information principles. In a more general spectrum, Article 12 of the Universal Declaration of Human Rights stipulates that:

No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honour and reputation. Everyone has the right to the protection of the law against such interference or attacks.

This makes the UN a legitimized institution to develop a consistent answer to the problematic described herein.¹²¹

120 See: I-U Petersmann, "Time for Integrating Human Rights into the Law of Worldwide Organizations," The Jean Monnet Program, Jean Monnet Working Paper 7/01, available at: <http://www.jeanmonnetprogram.org/papers/01/012301.rtf>, last visited 20/05/04.

121 Furthermore, WSIS Declaration of Principles has stated: "20. Governments, as well as private sector, civil society and the United Nations and other international organizations have an important role and responsibility in the development of the Information Society and, as appropriate, in decision-making processes. Building a people-centred Information Society is a joint effort which requires cooperation and partnership among all stakeholders," emphasis added.

V. Concluding Remarks

The early "euphoria" of the new economy revolution called the attention to certain rights of the individual that could remain unbalanced if not properly addressed. The structure of the Internet demonstrated that these intrinsic risks could, as a consequence of threatening individuals' rights, hamper Information Society and e-commerce progress.

The "euphoria" of progress was, due to its influence in EU-US relations, transmitted into the NTA "policy." The EU and the US jointly considered that, in order to contribute to the expansion of world trade and closer economic relations, in particular for the expansion of e-commerce, it was necessary to ensure the effective protection of privacy with regard to the processing of personal data on global information networks.

However, this political agreement has not been fully translated into regulation to guarantee its effectiveness. The way from "policy" to "regulation" has not been completed. Of course, the problem lies between the different conceptions about the type of "regulatory method" needed: State regulation, co-regulation, self-regulation, regulation through technology, and the degree of exclusion or complementarity among them. The point of view of the EU and the US is quite different: European stakeholders are more confident in legislation, administrative actions and criminal sanctions in order to fight against privacy threats. At the same time, we have to consider the scarcity of public awareness and Courts' interventions. This attitude is criticized by certain American stakeholders, asserting that the market, under the pressure of the media and the Human Rights associations will lead to the adoption of appropriate privacy rules. To date, most of the Privacy cases have been developed within US, even if (or "because of"?) there is no comprehensive Privacy Act.

Nevertheless, this is not an issue that can be solved and legitimately decided only by the EU and the US, since the effects have a global impact. Potentially, the absence of a bilateral agreement could give room to a wider dialogue and solution, for instance at the UN level. Notwithstanding, such a wide Agreement would take a remarkable long negotiating period. In the meantime, the US and EU would have to look closer at the NTA and decide if they will continue the same line of action in what concerns privacy and data protection, and if so, they will have to try to reach a degree of consensus for harmonization. Consensus at this bilateral level, would pave the way for broader consensus.

So far, the transatlantic dialogue has been very concentrated on the search for solutions to avoid the application of Article 25(1) of the Directive to the US. A complete view of TBDF scenarios, applicable law and jurisdiction issues can help to have an understanding of other cases that are excluded from the scope of

application of Directive 95/46/EC, yet are surrounded by legal uncertainty for the digital market place actors.

Finally, it has to be noted that, after the tragedy of 11 September 2001, many initiatives involving TBDF for security and fight against terrorism issues have taken place. Those initiatives, e.g. the airline passengers' data case, would affect not only the application of Directive 95/46/EC, but also other areas of EU law, like third pillar issues. In the scope of the NTA, it is clear that they exceed the third shared goal, but fall within the second shared goal. Thus, it will be necessary to assess to what extent the scope of privacy negotiations should be broaden also in this direction, bearing in mind that the solution already adopted by the European Commission may encounter certain limitations.¹²²

122 Commission Decision of 14 May on the adequate protection of personal data contained in the Passenger Name Record of air passengers transferred to the United States' Bureau of Customs and Border Protection, C(2004) 1914, available at: http://www.europa.eu.int/comm/internal_market/privacy/docs/adequacy/pnr/c-2004-1914/c-2004-1914_en.pdf. See: see M.V. Perez Asinari and Y. Poulet "The airline passenger data disclosure case....," op. cit. See also, by the same authors, "Airline passenger's data: adoption of an adequacy Decision by the European Commission....," to be published in Computer Law & Security Report.

Comments

Gregory C. Shaffer

As Yves Poullet and María Verónica Pérez Asinari point out in their excellent overview, the US-EC agreement establishing Safe Harbor Principles has encountered significant problems in its implementation. In this comment, I will not reexamine why the agreement's implementation has encountered challenges. I will rather point to two areas of research that suggest ways in which the agreement could be having effects on both sides of the Atlantic.

First, as I have pointed out elsewhere, an analysis of the impact of the safe harbor agreement cannot be limited to an assessment of the number of US companies that have signed up (603 as of November 2004)¹ or the content of these firms' online policies, although these factors are of course important. *What is also of interest is how the Safe Harbor Principles may informally affect firm practice, including through empowering and providing incentives for market and government actors within the United States and Europe.*²

Unlike the mutual recognition agreements assessed in chapter 7, the Safe Harbor Principles constitute a loose form of harmonization of social standards. The Principles go beyond current regulatory requirements in the United States to set

1 See <http://www.export.gov/safeharbor/> (visited Nov. 7, 2004).

2 For a fuller analysis that takes such a socio-legal approach, see Gregory Shaffer, "Globalization and Social Protection: The Impact of EU and International Rules in the Ratcheting Up of US Privacy Standards," 25 *Yale Journal of International Law* 1 (2000); and Gregory Shaffer, "Reconciling Trade and Regulatory Goals: The Prospects and Limits of New Approaches to Transatlantic Governance through Mutual Recognition and Safe Harbor Agreements," 9:1 *The Columbia Journal of European Law* 29 (Fall 2002).

general standards with which trading firms should comply if they wish to receive data from Europe without threat of legal challenge within Europe. This loose harmonization is designed to affect only trading firms, and otherwise to create no legal obligations within the United States itself. The United States and European Community ("EC") may thereby claim that they formally retain autonomy to enact whatever privacy legislation that they wish. However, any firm that engages in transatlantic exchange is subject to at least some pressure to take the Principles into account. Europe's regulatory approach can thus have spillover effects within the United States, leading to some convergence in data privacy practices, despite differing US and EC regulatory systems.

Whether or not companies formally certify to the Safe Harbor Principles, those engaged in transatlantic business operate in the shadow of the potential enforcement of EC internal law, and, in particular, Directive 95/46/EC on the Protection of Individuals with Regard to the Processing of Personal Data and the Free Movement of such Data (the "Directive"). Today, US businesses face potential litigation before European courts and administrative bodies under the Directive unless they adhere to the Safe Harbor Principles. Playing off the US-EC regulatory conflict and its media coverage, privacy advocates have been able to increase pressure on US federal and state politicians, regulatory authorities, and businesses. Even though privacy advocates have criticized the Safe Harbor Principles, privacy advocates can use them as part of their larger strategies. For example, Microsoft entered into a consent decree with the Federal Trade Commission in August 2002, resulting in Microsoft's agreement "to be monitored for 20 years" by the Commission under the threat of severe civil penalties. The government charged Microsoft with not abiding by its privacy policies for users of its .NET Passport system. These privacy policies, in turn, were shaped by Microsoft's agreement to adhere to the Safe Harbor Principles.³ The context in which US domestic debates about, and enforcement of, data privacy protection have been altered.

The Directive has particularly increased the demand for legal and consulting services within the United States regarding privacy policies. The Better Business Bureau OnLine created a privacy seal program which incorporates the Safe Harbor Principles, and which was revised to track "safe harbor" negotiations. The Electronic Frontier Foundation, a San Francisco-based public interest organization, associated with information technology companies to launch a program named

3 See John Schwartz, "Settling with FTC, Microsoft Agrees to Privacy Safeguards," *New York Times*, at C6, August 9, 2002. See also "EC Delays Revising Data Protection Edict; Survey Results to be Basis of New Proposal," 19 *International Trade Reporter* (BNA) 1169 (July 4, 2002) (noting that "the provisions of the EU data privacy law[...] have triggered an inquiry into the Microsoft .NET Passport system that allow companies to control access to their Web site," and that "EU member states are also looking into the possibility that online music providers such as Real Audio are in violation of the EU data privacy law").

TRUSTe to rate the privacy protection of Internet sites, which program was certified under Safe Harbor. Trade associations such as the Direct Marketing Association designed their own programs for their members to comply with Safe Harbor requirements. These certification groups have met with European data protection officials so that European officials are comfortable with the workings of their programs.

The EC Directive also helped to spur the creation of a new corporate position in the United States—the chief data privacy officer in a company's human resources division. These company employees attend conferences on the Directive and US privacy legislation, write memoranda on privacy issues that they distribute within the firm, and generally increase firm awareness of privacy issues.⁴ In formulating and overseeing the implementation of company policies, they foster company compliance with applicable legal requirements. Outside law firms also market their services to firms regarding the Directive and the Safe Harbor Principles, again promoting adaptation of US business practice. This conjunction of lawyer, consultant and "privacy officer" advice, rendered in the context of the Safe Harbor Principles, can lead to changes in privacy policies over time.

While the Safe Harbor Principles do not formally apply to domestic data processing operations, US-based enterprises recognize that it will be difficult for them to use two sets of data privacy practices, one for EC residents (providing for greater privacy protection), and one for US residents (providing for less). Business databases will often include information about EC and US residents, in which case businesses will be pushed to comply with the EC's more demanding requirements. As Robert Kagan notes in his evaluation of business practices in multiple industries, there is "evidence for a dynamic toward trans-national "corporation-level" harmonization of regulatory compliance routines in multinational companies, keyed to compliance with the most stringent national standards (sometimes with a margin of error)."⁵

Secondly, the Safe Harbor negotiations can affect data privacy practices in the EC as well. In negotiating the Safe Harbor Principles and putting them into operation, European officials have become more comfortable with the potential of US governance approaches involving the use of private bodies, such as

4 See, for example, US Department of Commerce News release, "Compliance with EU Data Protection Requirements & Safe Harbor Workshop to be held in Chicago on November 18," (on file, obtained from <http://www.export.gov/safeharbor/>, visited Nov. 7, 2004). The web site advertised, "On Thursday, November 18, 2004, the US Department of Commerce, in conjunction with BBBOnline, will hold a workshop on EU data protection compliance issues and the US-EU Safe Harbor framework in Chicago, IL").

5 See Robert Kagan, "Consequences of Adversarial Legalism," in *Regulatory Encounters: Multinational Corporations and American Adversarial Legalism* (Robert Kagan & Lee Axelrod eds.), at 374.

BBBOnLine, for the monitoring and certification of privacy practices. As Henry Farrell points out, European officials have indicated that they are willing to entertain the adaptation to the European context of less-centralized US regulatory mechanisms for data protection.⁶ The President of the European Parliament even called the Safe Harbor approach a "template for the future," serving as a potential model for regulation in other policy areas.⁷

Although the EC Directive arguably provides for greater data privacy enforcement in Europe than in the United States, the true test lies in the practice of member state regulators. These practices are sure to vary because of different national traditions and social contexts. Yet, in general, European governmental authorities have limited staff and resources and cannot possibly monitor all company practices throughout the world, much less in their own countries. Officials thus realize that they may need to rely on public-private networks in order to ensure better practices affecting European constituents. Their knowledge of the US system made possible through the negotiation and monitoring of the Safe Harbor Principles can spur adaptations in Europe to more market-based and private-oriented oversight and enforcement mechanisms. As a Commission representative noted, "[T]he discussions that eventually led to the Safe Harbor agreement were an enormous learning experience for both sides... Initially, we both took stances that were rather simplistic, because we didn't know any better."⁸ These developments in Europe, while upsetting some privacy advocates, could lead to convergences on the European side.

Effective regulation of data privacy in a global economy requires the meshing of different regulatory systems and a commitment from the various actors to sustained interaction to ensure trust and confidence in each other's efforts. From a practical standpoint, the goals of protecting individual privacy, on the one hand, while ensuring liberalized trade, on the other, are inseparable. Regulation in a jurisdiction with less stringent data privacy controls has significant externalities, thereby affecting residents in other jurisdictions. The Safe Harbor Principles are an example of an instrument for reconciling these regulatory concerns with the goals of a liberal trading order. They represent a form of compromise that recognizes different institutional approaches and social values, yet sets baseline rules where domestic values are affected by trade.

6 Henry Farrell, "Constructing the International Foundations of E-Commerce—The EU-US Safe Harbor Agreement," 57:2 *International Organization* 277 (2003).

7 Speech of Pat Cox, Sept. 8, 2000, cited in Farrell, *supra* note 9.

8 Cited in Farrell, *Constructing the International Foundations of E-Commerce—The EU-US Safe Harbor Agreement*, *supra* note 9. Farrell applies a constructivist approach to mutual learning among public and private actors on both sides of the Atlantic that made the agreement possible.

Chapter 7

Managed Mutual Recognition in the Transatlantic Marketplace

*Kalypso Nicolaïdis
Rebecca Steffenson*

I. Introduction

The New Transatlantic Agenda (NTA) (1995) outlined EU-US intentions to pursue transatlantic mutual recognition agreements (MRAs) for goods. The subsequent framework agreement for mutual recognition, which entered into force on 1 December 1998, was soon praised as one of the greatest “deliverables” produced by the NTA process. Transatlantic policy officials proudly publicized the agreements as a “milestone” in EU-US regulatory co-operation (Nicolaïdis and Egan, 2001, Shaffer 2002), and the incorporation of mutual recognition into the transatlantic marketplace was widely viewed as a great policy success (see Steffenson, forthcoming 2005). Consequently, the Transatlantic Economic Partnership (TEP) (1998) included a commitment to expand mutual recognition to other goods as well as service sectors. The TEP raised the stakes from the initial MRA negotiations and created hopes that the “success” of the 6 initial MRAs would lead to the negotiation of new annexes in additional sectors. Enthusiasm for mutual recognition as a regulatory strategy faded when three of the six goods sectors failed to pass from the transitional confidence-building process into operational agreements by the

established deadlines.¹ A new MRA was successfully negotiated for marine safety equipment, but other agreements did not materialize in other sectors such as road safety and cosmetics, which had been under consideration. Furthermore, negotiations failed to really get off the ground in any of the service sectors identified in the TEP. Instead, it appeared that other types of regulatory co-operation were being discussed in sectors like insurance and financial services under the Positive Economic Agenda (2002). In addition, the focus of the Transatlantic Business Dialogue, which had originally been “deeply embedded” in the MRA decision-making process (see also Cowles 2001), had also shifted by 2004 to deeper forms of transatlantic regulatory coordination including harmonization and equivalency agreements, which are admittedly a form of MRA by another name.²

The lack of movement on the MRAs created serious doubts about the feasibility of MRAs as a transatlantic regulatory strategy. This paper examines the debate surrounding the negotiation and implementation of these agreements. It has two aims. First, it examines the application of mutual recognition in the transatlantic marketplace and takes stock of the current state-of-play for both the implementation of MRAs in goods and the negotiations of MRAs for services sectors. The second aim of the paper is to draw what lessons we can from the negotiation and implementation, or lack of, of these agreements. We argue that this case reinforces the need to craft “managed” processes of mutual recognition.

Section two outlines an analytical framework for managed mutual recognition and highlights different ways that the application of mutual recognition can be controlled. Section three uses these analytical tools to explain the disappointing outcome of the goods negotiations. It highlights the role that trade policy officials played in managing the negotiating process under the NTA. Section four turns to the EU-US negotiations for mutual recognition in the services sectors, which ultimately failed to produce a framework agreement. Finally, section five sheds some light on the impact of different choices made by negotiators during the crafting of the transatlantic MRAs. It questions more generally what conclusions can be drawn about the management of mutual recognition in the transatlantic marketplace.

1 The framework MRA allowed 18 months to three years for the transitional phases depending on the sector.

2 See <http://www.tabd.com>.

II. Four Dimensions of Managed Mutual Recognition³

Mutual recognition is a complex regulatory tool for liberalizing trade which, depending on where it is applied, calls for conditions which in turn produce many different types of agreements. This is what we refer to as “managed mutual recognition.” As an outcome, managed mutual recognition can be compared with “pure” mutual recognition in the same sense as managed trade can be compared with total free trade. Pure mutual recognition implies granting fully unconditional and open-ended rights of access. In contrast, mutual recognition in operational terms actually involves complex sets of rules and procedures, that may serve to reduce, if not eliminate, the open-endedness of mutual recognition. Four dimensions are outlined below to indicate how mutual recognition can be managed as a process. Most importantly, these conditions are introduced and can be traded against one another to make recognition possible even under difficult conditions.

A. *Ex-ante Conditions for Equivalence*

Mutual recognition agreements aim to reduce redundant testing procedures or, in the case of professional services, duplicate licensing and/or accreditation processes, which inhibit the free movement of products and professionals. However, parties who agree to mutual recognition need to first establish that the level of regulatory protection provided will not be lowered by this arrangement. In order to do so, a decision must be made about the level at which equivalence is to be assessed. Equivalency is determined through a complex evaluation process, which usually takes place during a period of confidence building. In order to conclude this process regulators must be satisfied that their counterparts regulatory system adequately fulfils the objectives set out by its own. Failure to agree on equivalency of diverging regulatory systems limits the level at which an MRA can be pitched.

The European Commission makes a distinction between “traditional” MRAs, which focus on the mutual recognition of conformity assessment certifications without alignment of relevant standards, and “enhanced” agreements which are based on equivalence or, even better, common rules.⁴ It has now concluded that the former (e.g. traditional MRAs are simply not feasible or viable. Recognisably there are many grey areas between these black and white lines. The conditions of equivalence are determined ex ante through an evaluation process which determines the compatibility of different regulatory systems. For mutual recognition of goods, substantive requirements for product approval and/or the conformity assessment

3 This section draws heavily on the analytical framework applied to professional services outlined in Nicolaïdis 2004, which in turn draws from Nicolaïdis 1993a; 1993b; 1995, 1996, 1997, 2000a, 2000b, 2001a, 2001b, 2001c.

4 Taken from Commission Staff Working Paper 25.08.2004.Sec 2004 1072.

process influence the level of convergence. During ex-ante evaluation processes regulators review documentation, conduct onsite evaluation of laboratories, observe inspections and conduct audits. For full equivalency or "enhanced" agreements, which apply to standards, regulators review technical regulations, which can include product characteristics or related processes, production methods, as well as symbols, packaging, marking or labelling requirements of a product, process or production method. Conformity assessment procedures which are assessed may include processes of sampling, testing and inspection, evaluation, verification and assurance of conformity, registration, accreditation and approval of products.

As applied to professional services, conditions for equivalence are established by determining how compatible qualification and licensing requirements are. Mutual recognition agreements can cover substantive requirements or professional standards, that is the criteria for determining adequate professional qualification and for accrediting training institutions, including the content of studies and licensing examinations. They can also be applied to qualification and licensing procedures, i.e. the set of procedures by which individuals are made to conform and comply with these requirements, including through examination, and the process by which the institutions that certify them are themselves accredited. The "test of equivalence" between systems that underpins recognition can be conducted concurrently or alternatively with regards to the explicit standards of education, training and licensing in and of themselves or between the procedures followed by licensing and accreditation bodies.

B. Automaticity of Access

Once a decision is made about the equivalency of regulatory requirements, the question arises whether only national systems as a whole must pass such an equivalence test or whether, given some broad equivalence at the macro-level, some residual equivalence is to be tested at the individual level. Fully automatic recognition would mean that any national stamp or license from a country that is part of the system would attain automatic access to the rest of the system. The right to approve products would automatically be extended to all those capable of conducting tests for the domestic market. For services, it would automatically extend the right of professionals from one country to practice in another. However, because full equivalency is so difficult to establish, most MRAs are unlikely to allow for such a high degree of automaticity.

Many MRAs for goods limit recognition to the competence of laboratories and conformity assessment bodies to conduct product tests. Access is more or less automatic depending on the accreditation process for CABs under the agreements. Automaticity is higher when CABs that are approved for the domestic market are automatically able to operate for the foreign market. Automaticity is lower when CABs are required to apply to foreign regulators for approval. Under the EU-US

agreement, CABs have to undergo an individual evaluation process before they can be listed as approved bodies.

MRAs for professional services almost always fall short of setting up single passports for professionals. Rather, they constitute agreed mechanisms whereby the host country "takes into account" the qualification obtained in the home country, and where foreign professionals are granted "adequate opportunity for recognition." Eligibility criteria include recognition of professional experience and competence. Competence can be ascertained through facilitated examination and aptitude tests, or during a transitional pre-recognition period of local practice. Here the emphasis is clearly put on individual professionals rather than education and accreditation systems.

C. Variations in Scope

Mutual recognition can also be limited in terms of its scope. Limiting scope during the initial phase of a mutual recognition process can be seen as an opportunity to create a laboratory to test the impact of liberalization. Steps towards full mutual recognition can be achieved through the progressive expansion of scope. In the meanwhile, some beneficiaries of recognition might be satisfied with performing only some activities, for some period of time, as reduction in scope calls for.

Negotiators of MRAs need to determine what products will be included and what facets of the regulatory system are to be reciprocally recognized. The agreement could apply to certain parts of a finished product or to individual aspects of the conformity assessment procedures. For example, an agreement might include pre-market reports but exclude quality assessment reports. In the EU-US mutual recognition agreement, the pharmaceuticals sector was specifically limited to inspections for certain practices.

Professional services agreements can be limited by what range, mode and object of practice professionals will benefit from under mutual recognition. That scope of access falling under mutual recognition can be circumscribed in different ways. One basic way to limit the scope of recognition is to withhold the right to use the local professional title. The title signals to the potential client that the professional is a licensed or certified "architect," "lawyer" or "accountant" with credentials equivalent to those of local practitioners and is therefore the ultimate evidence of recognition. Agreements can also limit the scope of permissible activity or consumer type, apply rules of conduct and enforcement, or grant only temporary access.

D. Ex-post Guarantees

MRAs may give different emphasis to the setting up of cooperative mechanisms between parties in order to compensate for loss of host country control. The aim is

to increase the confidence that parties have in the mutual recognition process and therefore the legitimacy and sustainability of the agreement. For mutual recognition of goods these include mechanisms for monitoring laboratories and conformity assessment bodies, processes for contesting compliance, the right to suspend or even withdraw activities upon non-compliance and dispute settlement processes through, for example, a joint committee. These mechanisms in the professional services sectors include mutual monitoring aided by: obligations of transparency of regulatory systems, decision making process, and change in such systems through the continued exchange of information between licensing, registration and certification bodies; rights of regulatory oversight and mutual monitoring that allows for the continued assessment of technical competence, capabilities, and efficiency. The development of extant cooperative networks among parties can also be established to collectively "manage" the implementation of mutual recognition. Dispute settlement resolution and reversibility can also be used to maintain host country control.

III. The MRA Framework Agreement for Products⁵

The varying degrees to which ex-ante equivalency conditions, automaticity, scope and ex-post guarantees are used to control the application of mutual recognition demonstrate not only the complexity of mutual recognition agreements as a regulatory strategy but also their flexibility. The EU-US MRAs demonstrate just how difficult these agreements are to negotiate and implement and how different types of "management" of recognition have been used to try to circumvent such difficulties. The initial EU-US MRA was signed in 1997 as a framework agreement, which included annexes in six individual sectors (see table 1). The agreements were limited in scope to conformity assessment processes. In other words these were traditional MRAs. Their aim was to eliminate duplicate conformity assessment procedures that require manufacturers to undergo multiple testing, inspection and certification of goods when they export products.⁶ The scope of the agreement in the pharmaceuticals sectors was restricted even further to Good Manufacturing Practices (GMPs) certification.

Conformity assessment procedures, like technical regulations, are shaped not only by market demands, which facilitate trade, but also by regulatory demand for consumer health and safety. Mutual recognition requires domestic regulators to

⁵ Based on Steffenson 2002, 2004.

⁶ Conformity assessment procedures are used to assess that products comply with standards or regulations. These processes include sampling and testing; inspection; certification; management system assessment and registration; accreditation of the competence of those activities and recognition of an accreditation program's capability (see the National Institute of Standards and Technology's website at <http://ts.nist.gov/ts/hdocs/210/gsig/cainfo.htm>).

accept the competency of their foreign counterparts to conduct product testing. However, regulators remain accountable to domestic legislators for the product standards that are applied both to domestic and foreign products. Regulators on both sides of the Atlantic are thus generally reluctant to transfer authority to a foreign body, and the MRA negotiations demonstrated that some regulatory bodies are more reluctant than others. While European regulatory agencies expressed general concerns about accountability in the US regulatory system, the main objectors to the process were the FDA, which negotiated the annex agreements for the medical devices and pharmaceuticals sectors, and the Occupational Safety and Health Administration (OSHA), which negotiated the electromagnetic compatibility MRA.

This section examines the controls placed on the MRAs which effectively limited both their scope and automaticity. The attitudes of regulatory agencies to mutual recognition agreements has, especially in the case of the transatlantic MRAs, had a major impact on the negotiation and implementation of the agreements. During the transatlantic negotiations, trade officials adopted the role of policy managers over the MRA process. However, this case study highlights problems with the European Commission's initial management strategy.

A. The Framework MRA

The Commission approached US regulatory agencies as early as 1992 to initiate the negotiation of MRAs. However, it faced strong opposition from some US domestic regulatory agencies. In particular the FDA argued from the start that the Commission's proposed strategy was inconsistent with its regulatory mandate. The negotiations remained deadlocked until the "bottom-up" strategy, i.e. negotiations with individual regulatory agencies, was replaced with a new "top-down" strategy. The inclusion of MRAs in the NTA brought the negotiations under an institutional framework whereby the task of facilitating mutual recognition was primarily delegated to US trade rather than regulatory agencies (see Steffenson 2004).

The new negotiating strategy bought a breakthrough in the negotiation process because the Commission naturally found USTR more receptive to the MRAs than US regulatory agencies had initially been. However, the new institutional arrangements for negotiating the MRA led to increasingly intense discussions between US trade officials, who negotiated the overarching umbrella agreement, and US regulatory agencies, who negotiated the sectoral annexes.

Under the NTA, USTR and the Commission became managers of the MRA process. While trade officials on both sides of the Atlantic agreed that the MRAs should be pursued, they clashed over how to incorporate the concept of mutual recognition into an agreement. First, the Commission pushed for full equivalency agreements similar to those which exist within the EU. However, US negotiators made it clear from the start that full equivalency agreements were not feasible.

USTR could not negotiate an agreement that would require changes to US domestic laws, because it did not have negotiating authority from the US Congress.

USTR trade officials were also opposed to the framework approach advocated by the Commission. They argued that involving too many sectors would also increase the number of regulators participating in the negotiation process, which would ultimately result in an unreachable threshold of agreement. Instead they favoured negotiations for a limited number of products on a sector-by-sector basis. In the end, the sectors included in the framework agreement reflect the bargaining power of both USTR and the Commission. The Commission would not agree to MRAs on telecommunications and recreational crafts—viewed as advantageous to the US—unless there were also MRAs on pharmaceutical and electrical safety. A number of sectors suggested by the Commission were pushed off the negotiating table all together because they were deemed to be compatible with the US domestic legal system (see Ives 1997: 28; Vogel 1998). Sectors such as aviation, pressure valves, road safety equipment, lawn mowers and personal protective equipment were either viewed as too controversial, because they posed serious health and safety issues, or believed to have incompatible regulatory regimes. The original framework agreement did, however, leave open the possibility of negotiating MRAs in other sectors.

The framework agreement tied domestic regulators in the included annexes into a process managed by trade officials. While regulators maintained control of all technical, policy related negotiations, the individual annexes were bound by the timeframe and institutional arrangements established in the framework agreement.

The framework agreement established a process for the designation of procedures for mutual conformity assessment. Domestic regulators were joined in Designating Authorities, which were charged with evaluating, listing and monitoring private conformity assessment bodies. In addition, and despite objections from many US regulatory agencies, a Joint Committee composed of trade officials and regulators was established to serve as a dispute resolution forum.⁷ The framework agreement drew on the model MRA drawn up by the European Commission which pushed for rapid agreement in exchange for long confidence building processes.⁸ In

7 The FDA was opposed to setting up the Joint Committee to oversee conformity assessment because the committee would increase the potential opportunity for trade agencies to dominate the process (see Ives 1997). It requested a Memorandum of Understanding (MOU) with USTR to secure clear authority for the FDA in the sector annexes and reserved an "observer" role for USTR in Joint Committee meetings where FDA annexes were discussed. See Steffenson (2004).

8 The institutional design and most of the language used in the agreement is derived directly from a Model MRA the Commission presented to the Council when it sought negotiating authority for external MRAs (see Steffenson 2002).

addition the agreement allowed for only low automaticity, because individual CABs were required to apply for access during this transition process.

B. The Non-operational Annexes

EU regulators did have some initial concerns about the fragmented (see Egan 2001b) and decentralized (see Cowles 1997) nature of US regulatory policy during the annex negotiations. They argued that the autonomous role of many US regulatory agencies blurred the lines of regulatory accountability in the US and they queried whether regulatory quality was undermined by the lack of standardized requirements (see also Nicolaïdis 1997b; Egan 2001b: 14). However, structural changes to the US regulatory system were quickly made to reassure European regulators. In particular, the National Institute on Standards—an agent of the Commerce Department—created the National Voluntary Conformity Assessment Program to accredit conformity assessment in the US.

Much larger challenges were posed by diverging regulatory cultures. The regulatory culture within the EU internal market is considered “trade friendly,” because EU and national regulators operate with dual missions to promote free trade within the internal market while ensuring public safety (Petriccione 2001: 220; Shaffer 2001: 7). However, many US agencies have narrower mandates that focus solely on public health and safety. Moreover, it can be argued that US regulatory agencies have a developed culture of regulatory superiority vis-à-vis European regulatory agencies and regulatory autonomy vis-à-vis USTR which are not naturally MRA friendly (see also Nicolaïdis 1997a). This certainly true of FDA and OSHA, which negotiated all three non-operational sectors.⁹

OSHA and FDA were able to exercise considerable control over the process through their strict management, as designating authorities, over the approval of CABs. The FDA maintained ultimate control to reject the reports issued by CABs should they find them to be deficient in any way (see Shaffer 2002). But, the agency was even more proficient in exercising ex-ante controls. Problems first arose initially from the use of private conformity assessment bodies (CABs) in the EU. The FDA argued that it could not delegate authority to approve private third party reports or manufacturing facilities inspections (see Ives 1997: 30). This position changed only when the FDA underwent structural changes to its regulatory mandate via the FDA Modernization Act (1997), which altered the scope of FDA control and

9 This culture of regulatory superiority is most evident in the case of the FDA, because the FDA considers its mark of quality to be the gold standard (Millen 1998; Horton 1998). One FDA official confirmed that “the FDA has a proud history. We felt no need to play in this—we are used to being authoritative.” Quoted in Steffenson 2004.

allowed delegation of authority to third party assessment bodies (Egan 2001b: 15).¹⁰ In addition, Congress instructed the FDA, in consultation with the US Secretary of Commerce, to support USTR in reaching an agreement with the EU on all products under its jurisdiction where MRAs would not lead to a reduction in the quality of standards (Merrill 1998: 742). Given this clause, the FDA stressed that the MRAs could not be considered a transfer of authority from the FDA to EU regulatory bodies but only as “contracts of service” for foreign CABs.

The process of mutual recognition essentially came to a halt in this sector because the FDA was unable to approve any European conformity assessment bodies during the transition period. In 2001, the FDA claimed it was close to being able to a list 4 CABs but, had not done so by June 2004. It claimed CABs had submitted incomplete information, and that it has received a poor response rate from EU companies asked to host joint audits into order to train EU CAB auditors.¹¹ US trade officials argue that there has not been a strong interest from laboratories or medical devices manufacturers.¹²

OSHA was also unable to approve CABs sufficient to make the electrical safety device annex operational. The agency engaged in a number of disputes with the Commission when it first, started charging a “processing” fee for applications for conformity assessment to compensate for the costs of approving foreign CABs, and second, rejected a number of CAB applications because they were made in French and Spanish (see Steffenson 2005). The Commission argued that OSHA had violated the agreement by creating a duplicating assessment fee. It also refused to cover the cost of translations, claiming it was too expensive, to which one OSHA official pointed rebutted, “we’re a domestic health and safety agency, we don’t do translations” (Alden 2001).

US trade officials claim that the Commission’s failure to diffuse the dispute over translations points to larger loss of momentum in the MRA process. European enlargement is largely believed to be responsible for this change, however, the Commission’s disengagement in the negotiations is also viewed as a political side-step in anticipation of a larger dispute over the equivalency of standards within the single market. The dispute stems from the fact that FDA has, in the pharmaceuticals sectors, insisted on evaluating each member state regime individually, and that it

10 The FCC also modified its regulations in order to recognize private testing bodies (Shaffer 2001: 15).

11 See Minutes from the Thirteenth US/EU MRA Medical Device Annex Stakeholders Teleconference, November 7, 2001.

12 Interview, USTR telephone, June 2004.

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has openly suggested that all member states are equal.¹³ To date the FDA has only approved testing certification in one member state, the UK. The process has now become dormant. FDA argues that the benefits of mutually recognizing GMPs do not outweigh the cost of reviewing each member state.¹⁴ The Commission objects to FDA's approach which threatens to undermine the credibility of the single market.¹⁵

Table 1
Correlation Between US Regulatory Positions and Policy Implementation¹⁶

Annexes	Policy Implementation
Telecommunications Electromagnetic compatibility	Operational
Medical Devices Pharmaceuticals	Not Operational
Electrical Safety	Not Operational
Recreational Crafts	Operational

C. The Operational Annexes

The annexes negotiated by the US Coast Guard and the FCC recognized the competency of their European counterparts to conduct conformity assessment bodies. Regulators did secure a number of ex-post guarantees. For example, under the annex for telecommunications equipment the FCC can conduct post-market surveillance on labelling and numbering requirements as well as border controls and internal checks (Shaffer 2002). However, in general there were far less problems determining access and the annexes on telecommunications equipment,

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- 13 One FDA official commented, "FDA knew Europe was not 'whole'." A US trade official affirmed the American perception that, "Portuguese standards are not the same as those in the UK." Interviews, Washington and Maryland, October 2000.
- 14 USTR agrees claiming, "There is just no reason to spend the money to do this." Interview, telephone, June 2004.
- 15 The Commission argues that, under the agreement, approval should be based on certification, issued by regulatory bodies in the domestic market, of the inspection reports regarding manufacturers' compliance. In contrast, the FDA argued that it could only certify GMPs after reviewing the full reports composed by national regulators. The problem was defused when the FDA accepted that it would "normally" be able to accept certification and agreed to work with European regulators to devise a common inspector report format. However, the process stalled before a report format was agreed (see Steffenson 2004).
- 16 Taken from Steffenson 2004.

electromagnetic compatibility and recreational craft were implemented with relative ease.

The annexes on telecommunications equipment and electromagnetic compatibility provide for the recognition of test reports and conformity assessment certificates issued by CABs. The relatively smooth implementation of the telecommunications annex has been credited to the FCC, which supports the agreement, and the existence of domestic constituencies which exert pressure in favour of deregulation of product approval processes (Shaffer 2002). The result is that there are now over 100 CABS operating in these sectors.

The MRAs are even credited with sparking further regulatory co-operation and deregulation. After the agreement was signed in 1998 the EU introduced self-certification of telecommunications which meant that manufacturers no longer needed to obtain pre-market assessment certificates. The FCC in turn instituted a new program which led to the use of private testing laboratories. Regulators on both sides supported the MRA and have supported more deregulation for pre-marketing approvals. In some ways, the MRA is becoming less relevant as more deregulation occurs.

The recreational craft annex was the easiest MRA to negotiate and implement, in part because there was already a large degree of regulatory co-operation between the US Coast Guard and the Commission. The US Coast Guard already permitted firms to self-certify, so there was no need for European CABs. In addition, the implementation of the annex was facilitated by the fact that the EC regulatory agencies have to adapt to a single regulatory system operating in one language.¹⁷

The success of the recreational craft MRA sparked further co-operation between the US Coast Guard and the European Commission. The Coast Guard approached the USTR about negotiating another MRA for marine safety equipment. In December 1998, at the request of the US Coast Guard, the USTR initiated negotiations with the European Commission under the TEP. The Lifesaving & Fire Safety Standards Division (G-MSE-4) of the Coast Guard worked in close cooperation with USTR to develop the product scope based on a detailed product-by-product review of the US and EC marine equipment requirements. The MRA for marine safety, which covers 30 types of equipment, was signed on February 27, 2004. Significantly this agreement is an MRA (+) which means that it includes the mutual recognition of some standards.¹⁸ This sector was uniquely suited to an MRA

17 See Shaffer 2002.

18 The MRA product scope includes 43 products in three main categories: life saving equipment (e.g. visual distress signals, marine evacuation systems); fire protection equipment (e.g. fire doors, insulation); and navigational equipment (e.g., compasses, GPS equipment, echo-sounding equipment). See US Coast Guard website at <http://www.uscg.mil/hq/g-m/mse4/mra.htm>.

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because there was a pre-existing level of harmonisation, prompted by international co-operation through the IMO, which also serves as a dispute settlement mechanism.

IV. The MRAs for Professional Services

The successful conclusion of a framework agreement for the mutual recognition of conformity assessment processes gave rise to a period of optimism in transatlantic economic relations. Why not then, extend the experience to other sectors, including and especially in services sectors, such as insurance as well as professional services (law, architecture, engineering)? By 1997-98 the General Agreement on Trade in Services was starting to be implemented. The GATS encouraged members, under article 7, to conduct MRAs in order to facilitate trade beyond the national treatment obligation commitments contained in national schedules. The EU suggested negotiations on a new framework agreement for mutual recognition of services and, in spite of its initial reservations due to the import of its federal structure in these areas, the US agreed to launch these new negotiations under the TEP (Article 3.22 of the TEP Action Plan).¹⁹ That framework agreement was to serve as a model for the negotiation of mutual recognition agreements on specific services sectors where there was participation from relevant professional and regulatory bodies. The aim was to make it significantly easier for professionals and firms to operate in the transatlantic marketplace both as an end in itself and as a way to facilitate the operations of cross-atlantic investment and MNCs.

A. *The Framework Agreement for Services*

At the EU-US Summit in June 21, 1999 it was announced that the finalized text of a framework agreement had been agreed and was to be subjected to domestic review. It was then left to trade negotiators to find sectors with willing participants. The original plan was to seek out possible services sectors, including financial and investment services as well as professional services. In August 2000, USTR listed a Federal Register Notice indicated that MRAs were being considered for certain sectors of insurance (e.g. commercial lines, reinsurance, agency/brokers), private pension fund management, and professional services including engineering and architecture.²⁰

19 These agreements should address the commercial interests of our respective services suppliers. In parallel and on the same timescale, we will work together to develop support from a critical mass of our respective responsible authorities to accede and implement the agreements as soon as possible (TEP Action Plan 1998).

20 Services: Regional Initiative, USTR briefing available www.ustr.gov/sectors/services/tep 8/11/00.

But the USTR quickly realized how difficult it would be to negotiate MRAs in each of these individual sectors. It set about approaching regulators, service providers and professional associations about the feasibility of negotiating MRAs, but its task was complicated by the fact that most of these sectors were subject to state regulation (some sectors exclusively). The resistance to the very idea of MRAs faced by USTR at the sub-federal level stem from a double suspicion: of federal involvement on one hand, with states constantly on the defensive regarding Congress' pre-emptive powers and the Commerce clause; and of foreign regulators suspected of seeking to undercut state-level professional through lower standards, especially in the case of home countries with high skills low wage professionals. After a year of investigation, USTR concluded that the federal government could not negotiate new MRA agreements in many service sectors, which in turn seriously hampered the credibility of the framework agreement itself.

Meanwhile, the EU Commission was frustrated with its lack of clear negotiating partner. It contemplated seeking out agreements with individual states, but in the end concluded that such an approach would not only be extremely time consuming and resource intensive but would undercut the very principle it was trying to promote, namely mutual recognition, within the United States themselves. Besides, EU professional groups would be bound to protest loudly to a scheme where their counterparts from an individual state would get access to the whole EU market in exchange for one out of fifty US states. Reciprocity, at least in the transatlantic context, still meant symmetry of access and comparable market opportunity. In order to ensure a level playing field, the Commission might not need to obtain access for its member states to the whole US territory, but it would at least need to obtain a critical mass of states in order to negotiate MRAs.²¹

The federal structure of US services regulation might have been the dominant barrier to negotiating transatlantic services MRAs but it was not the only one. Thus, even the pensions sector, which is federally regulated, was ruled out early on in the process, because the Investment Company Institute, the US national association which has enormous clout on the Hill, categorically opposed the MRA. The ICI argued that mutual recognition agreements were not the best way to de-regulate the sector, but called instead for removing regulatory that deny effective market access.²² The latter strategy would of course be unilateral and therefore conducted at the appropriate speed.

21 European Commission, DG Trade, *The Transatlantic Economic Partnership Overview and Assessment*, October 2000.

22 Investment Company Institute letter to USTR, September 11, 2000. Available at http://www.ici.org/issues/glo/arc-mrk/00_ustr_transatlantic_com_cvr.html.

B. Individual Sectoral Work Plans

As sector after sector was excluded from the scope of the services MRA, the framework agreement fell apart. Instead, it was decided at the end of 1999 to seek out work plans for individual professional services sectors. But, by time of the EU-US summit in Washington (2000) it was clear that the insurance sector was causing the most problems. After initial work plan discussions the US suggested it was interested in working towards establishing a "regulatory dialogue" rather than negotiating an MRA. In terms of the four dimensions of managed recognition outlined above, this meant that ex-ante equivalency conditions were to become the sine qua non to any further move towards recognition. It meant moreover that the process of regulatory cooperation underpinning such evolution was to be de-linked from any commitment to translate regulatory convergence into recognition commitments. As a result the MRA negotiations for insurance became dormant.

There were nevertheless some professional associations still interested in making progress. In April 2000, the first meeting of architects and engineers on mutual recognition was held. The meeting established a work plan which addressed: (1) respect of each others' regulatory systems; (2) determining equivalence of education; (3) determining equivalence of qualifications other than education; (4) notification to the World Trade Organization of the intent to negotiate mutual recognition; (5) scope of practice (particularly for engineers); and (6) implementation of agreements. The work plan allowed for confidence building between EU and US regulators to determine equivalence and suggested mechanisms to establish the scope and automaticity of a possible agreement. Some of these mechanisms included limitations on the use of professional titles (scope), and a timeframe to be included under mutual recognition.

The TEP Steering Group Report in 2000 gave the impression that negotiations in these sectors were well underway. However, many regulators and professional associations were unimpressed with the way the meetings had been conducted. US and EU government trade delegations ran the meetings, while representatives of professional and regulatory bodies were invited as observers.²³ The two sectors resented being lumped together and failed to see the benefits of participating in the joint process. In this way, the dynamic was close to what had prevailed within the EU itself when the Commission had decided to pool all the professions together in the *General Services Directive* of 1989. At the time, many of the professions had objected to the aggregation of their most specific and idiosyncratic universes. But with time, the Commission had been able to demonstrate that the GSD as a framework agreement allowed for flexible interpretation. It was hoped that maybe, just maybe, the same evolution could be engineered in the transatlantic context.

23 One association official complained that "it was conducted by trade people like a trade meeting!" Interview, telephone, June 2004.

C. Association to Association Agreement

Between 1996 and 2002, the OECD also conducted a series of studies and meetings on the relationship between trade liberalization and regulatory cooperation, including a special series of meetings on the professions. It was clear in these meetings that the professional associations would be the main players behind any kind of agreement and that these associations could be empowered to facilitate the MRA process. Indeed, while negotiations on an MRA for engineering came to a halt after the May 2000 meeting, the National Council of Architectural Registration Boards and the main US professional association, the American Institute of Architecture, met privately with the Architect Council of Europe to discuss a new negotiation process. They agreed on a primary accord, which they hoped to sign in 2005. The Accord on Co-operation and Professionalism in Architecture establishes that:

An American architect who possesses a professional diploma and is duly licensed by a US jurisdiction shall be recognized as an architect in any EU Member State, and an architect recognized under the terms of EU Directive EEC 85/384 in any Member State of the European Union shall be recognized as an architect throughout the United States of America.

It may have helped that European architects had been the last profession in the EU (after doctors and nurses) to benefit from their own sectorial directive in 1985. It may also have helped that this was one of the sectors with the most existing cooperation between firms and therefore important incentives to move the process forward.

Under such an approach, access to mutual recognition is ultimately placed on the individual who has to apply to their national association, which acts as a clearinghouse. Equivalence of education systems would not be established ex-ante and systematically but on an ad-hoc case-by-case basis. In short, the basis for mutual recognition would be practice and learning-by-doing. Ex-post guarantees were introduced through the continued review of the level of professional standards on both sides. The agreement also states that participants are subject to the standards of ethics and professional conduct of their host country, thus reducing the scope of standards actually recognized as equivalent.

Many Europeans were nervous about forging an agreement without the direct involvement of the US government, but a government to government agreement was not possible in a sector that was not only regulated at the state level but where professional associations bare such a great burden of control. Final ratification of the agreement will depend on state regulators, however it is widely believed that the National Council of Architects Registration Board's vote will serve as the green light for state regulators. Individual states will still have to incorporate the agreement into their own rules and enforce such recognition in individual cases. Nevertheless, as with the case of products, it was important for the Commission to

ensure that ultimately, the US government would be considered responsible for compliance with the agreement. As a result, once agreement has been reached at the level of the architectural profession, it will be passed on to the trade representatives of the Federal Government of the United States of America and of EU Member States and the Trade Directorate (DG TRADE) of the European Commission. It will only become binding once an agreement has been reached at political level and is included as part of the Transatlantic Economic Partnership (TEP) or any future agreement between the relevant political entities.

V. The Implications of Choices Made During MRA Negotiations

MRA negotiations for both goods and services demonstrate how important it is to manage mutual recognition as a process. Trade-offs can be made during the negotiation process between different ways of limiting the impact of mutual recognition and ensuring incremental liberalization and therefore incremental "regulatory competition." This section examines those trade-offs both in theory, and as applied to the EU-US mutual recognition agreements. Finally, it summarizes what lessons can be drawn from the non-implementation of three goods sectors and the dormant services negotiations.

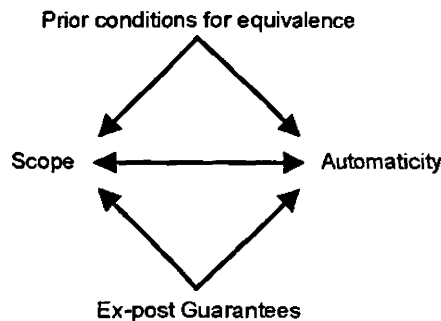
A. *Trading Prior Conditions for Ex-post Guarantees, Automaticity and Scope*

At the systemic level, MRAs are based on prior harmonization and/or criteria for equivalence and cooperative mechanisms to make up for loss of host country control once the agreement is in place. Less equivalence will have to be compensated by reduced scope and automaticity as well as ex-post guarantees. The individual candidate for recognition, be it a professional or a CAB, will be affected by the provisions on how automatically and on what basis the recognition is granted, and the scope of recognition set out in the MRA, that is the range and mode of practice accessible to the beneficiary of recognition. How confident the parties are on the degree of equivalence between their systems will determine how automatically they are ready to grant recognition. How broad a scope for access is envisaged will also determine automaticity. The need for spelling out prior conditions of equivalence may be reduced if there are good prospect for sustaining a high level of cooperation after the agreement and if reversibility is a plausible option of last resort.

In short, whether implicitly or explicitly, trade-offs can be exploited among the features of an MRA. The more parties are aware of these potential trade-offs, the higher the likelihood that they will reach agreement and devise solutions acceptable to all. In some cases, it may be more appropriate to relax prior conditions of equivalence and concentrate on fine-tuning automaticity (EU). In others, reducing

initial scope may be considered as a way to test the grounds (NAFTA, EU-US product MRAs). From a dynamic viewpoint, scope and automaticity can be reduced initially to accommodate insufficient prior equivalence and expanded later on in light of ex-post cooperation.

Figure 1
Trading off Between Features of Mutual Recognition (from 2004)²⁴



Parties need to decide how quickly they want the agreement to come into effect and how many resources they will be able to devote to managing its implementation. This means deciding whether the regulatory cooperation that must necessarily accompany mutual recognition needs to bear fruit *before* the agreement is actually implemented. Although regulatory assurances are necessary before and after liberalisation, if there is a sense of urgency, they can focus on *ex-post* guarantees. On the other hand, when resources may be insufficient to manage the guarantee mechanism *ex-post facto*, it may be wiser to seek high thresholds of equivalence earlier in the process. One of the central “twists” that allowed Europeans to respect (more or less) their 1993 deadline for the internal market is the resort to a shift from mandatory and extensive ex-ante cooperation and harmonisation to on-going ex-post cooperation. This does not mean that the scheme ought to be reproduced everywhere, especially where no prior culture of regulatory cooperation exists as is often the case in the transatlantic context.

If they are able to reach a high degree of prior harmonization—such as with the marine safety equipment MRA—parties can aim for an ambitious and immediate full scope recognition. Alternatively, parties can also exploit the potential for customized automaticity and reduced scope, to design a step by step approach to

²⁴ Taken from Nicolaïdis 2004.

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mutual recognition through incremental extension of automaticity and scope conditional on increased confidence between parties after the MRA comes into force. The choice hinges on the particular professional and regulatory cultures, whether harmonization is feasible, the characteristics of the customers of this particular service, whether the degree of regulation varies significantly between parties, etc. It is also important to ask whether less than full recognition makes a significant difference to entry in a particular context.

In summary, there is a rich set of possible trade-offs between automaticity and scope of recognition. Negotiators can pit a position favouring greater automaticity with reduced scope against lesser automaticity with full scope. Compromises can be made by introducing the possibility for *sequencing* these options, for example, through extended confidence building periods and by adding time restrictions as an incentive for local adaptation for scope of practice or by relying on local experience as the sole condition for scope expansion in terms of title in services.

In short, mutual recognition must be thought of as a dynamic process and the signing of an MRA as only one phase in this process. The key is to facilitate the mutual recognition process while accommodating the various interests in place without letting any of them stall the process. On the one hand, MRAs will certainly be easier to negotiate for parties who have moved down the road and have prior harmonization. On the other hand in cases where there is significant internal resistance to regulatory reform, the prospect of recognition or the actual negotiation of an MRA may be seen as a lever for change. An important question to ask is whether the real short term goal is to get an MRA up and fully functioning in order to facilitate trade or to get regulators and professions to embark on the road to mutual recognition (even at the cost of achieving an agreement with limited scope and limited recognition)?

B. Hard Lessons from the Transatlantic MRAs

The EU-US MRAs in both goods and services were negotiated as framework agreements. The Commission, in exporting its MRA model, insisted on an agreement that could reach a broad number of sectors, therefore fuelling more regulatory cooperation across the Atlantic. The horizontal approach adopted by the EU internally in the case of the *GSD* for instance attempts to ensure full sectoral coverage at the cost of automaticity. This model has a number of advantages. It allows for quicker agreement, because it does not attempt to bridge structural differences between national systems. It is seen as a way to achieve progressive liberalization, because it covers the broadest number of professional sectors possible. With regards to standards, it replaced ex-ante harmonization with conditional access and ex-post guarantees.

The aim was also to negotiate the transatlantic agreement quickly, in part because USTR and DG Trade were under pressure from both politicians and the

business community to produce a much needed transatlantic “deliverable.” The trade off is that these agreements relied on limiting not only the scope but also the automaticity of access under a number of ex-post guarantees. The idea was that US regulators would learn by doing and that the process would lead to more progressive liberalization.²⁵ The framework approach did manage to secure an agreement in sectors that had been deadlocked. The impact of mutual recognition could increase as MRAs in existing sectors give firms leverage to demand agreements in others (see Shaffer 2002). Nonetheless, the shortcomings of this approach are glaringly obvious. Three product sectors included in the original MRA remain non-operational and the services negotiations are essentially dormant. What lessons can we draw from the management of the transatlantic MRAs to date (e.g. June 2004)?

Government to government MRAs may be used to create frameworks and floors for recognition. Under the initial framework agreement trade negotiators were charged with managing the overall process, but ultimately some attention does need to be played to finding suitable sectors. Prior harmonization and comparable regulatory standards/processes create suitable atmospheres for mutual recognition. It is also key to finding sectors that are mutual recognition friendly. In some cases mutual recognition agreements can be used to alter domestic regulatory cultures.²⁶ However, the EU-US negotiations in the pharmaceuticals, medical devices and electrical safety sectors demonstrate how difficult it is to negotiate mutual recognition in environments where the regulatory culture is hostile to a trade agenda.

Regulatory agency support for mutual recognition agreements has proven to be one of the most important conditions for negotiating MRAs. Confidence building processes are time consuming and increase the costs of implementing agreements. In the case of medical devices and pharmaceuticals, the cultures of regulatory insulation and autonomy of FDA and OSHA created clear barriers to the negotiation, and more importantly to implementation of the MRAs. Fiercely autonomous regulatory agencies strongly opposed to mutual recognition created impasses in the process by ultimately resisting any hint of automaticity in recognising the stamps of foreign regulators. In the end, they seemed to view mutual recognition as a mechanism for regulatory division of labour and cost cutting rather than for the sharing regulatory sovereignty based on mutual trust. The lesson is that trade negotiators can only accomplish so much as policy managers.

25 A Commerce department official argues, “The MRAs are the first step in broader liberalisation of trade through mutual recognition and harmonisation of health and safety, environmental standards.” 25.

26 One FDA official even noted that in the medical devices sector, “we’ve been able to accomplish much more than we thought.”

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Bringing regulators into the process can encourage regulatory dialogue including exploratory discussions to increase awareness of foreign systems and confidence building is key to both the deeper and wider application of mutual recognition, even if it has not prompted regulatory convergence across the board. Ultimately, however, it is difficult to implement any agreement where regulatory agents call into question the compatibility of systems. Thus, the European Commission (2004) recently argued that a technical dialogue should proceed and in some cases replace any attempt to negotiate an MRA.

The support of industry and professional associations is also crucial to an MRA. The TABD has played a critical role in the MRA negotiations by lobbying USTR and the US Commerce Department. It offered technical support and exerted pressure on officials on both sides of the Atlantic to conclude the agreements. Non-implementation of the agreements, however, has curbed the momentum of transatlantic business. Under the leadership of PricewaterhouseCoopers and Electrolux (from 2001) the group's attention has turned to a number of new strategic issues including the growth of e-commerce, the WTO negotiations in Doha, dispute management, and mergers and acquisitions. A lack of support from the medical devices manufacturers has also undermined this sectoral annex. It is worth noting that the market often finds an efficient way to accommodate market access even where MRAs are not in place or where delays incur, such as, for example, when laboratories make reciprocal agreements independently (such as in the telecoms sector). There is also scope for enhanced MRA type co-operation through voluntary schemes, as seen with Energy Star and eco-labelling (see Commission 2004).

These different types of co-operation raise questions about the prospects of negotiating MRAs outside a framework agreement? The Commission has recently admitted that MRAs should be considered on an individual basis and that traditional should not be pursued with the US (or other trading partners). It argues that its focus should turn instead to negotiating enhanced MRAs only where there is a high degree of compatibility. US negotiators have always favoured sector by sector negotiations which limit the number of regulatory agencies involved (Egan 2001a; 2001b). Trade officials argued that there was no point in "lumping together unrelated sectors."²⁷ Sectoral agreements do have the potential to lead to more automatic recognition for qualified professionals and CABs, because they either involve some degree of co-ordination of education and training or can spell out criteria for recognition tailored to the sector in question (Nicolaidis 2004).

What conclusions can we draw about the management of the transatlantic MRAs? The EU's framework strategy inspired by its own single market approach

27 Interview, telephone, June 2004.

misses key elements when it is exported. In the transatlantic case it can be argued that the relationship lacks strong institutions with the depth to oversee and enforce the MRAs (see Egan and Nicolaïdis 2001, Petriccione 2001). Unlike the EU single market, there is no authoritative legal body—such as the ECJ—with the capacity to enforce mutual recognition. Although the Joint Committee is designed to act as a forum for dispute resolution, it has been unable to break the deadlock achieved by FDA and OSHA in the implementation process. The marine safety equipment MRA, on the other hand, benefits from the oversight of the IMO. Moreover, cooperative networks between professional associations are much less dense and there is no equivalent for the EU Commission which serves as the hub for the professional committees which, inside the EU, are the enforcers of ex-post guarantees including on the continued quality of professional training.

Finally, the association to association agreement in services raises questions about the capacity for MRA without government to government negotiations. There are risks involved in relying on accreditation bodies to provide the first building block of a two-layered approach to recognition. First, as pointed out by Bernard Ascher, this could in itself become a basis for restriction, if foreign schools are not afforded adequate opportunity for accreditation and if accreditation standards discriminate against them. Accusation of discriminatory treatment is a staple of the accreditation world at the purely domestic level. The same types of solutions are therefore called internationally as domestically: as with the domestic level, there may be appeals procedures regarding accreditation determination, accredited institutions may not have a monopoly in producing candidates for licensing, accreditation bodies can have specific mandates to allow for accreditation at the national of institutions that do not meet their conventional standards of accreditation in order to encourage diversity provided the institution carries out the purpose of the accreditation (Nicolaïdis 2004).

VI. Conclusion

MRAs cannot be crafted overnight or follow some grand design. They need to be adapted to the requirements of the particular industries and professions. At the same time, they need to be consistent with one another. Ensuring such consistency while spearheading faster and more efficient negotiations of mutual recognition agreements worldwide could be the object of new transatlantic action. In particular, regulatory cooperation between the US and the EU regarding professional services could serve as a stepping stone in the context of the Doha Round by demonstrating the potential for open MRAs.

More generally, transatlantic cooperation can contribute to creating a culture of mutual recognition whereby the professions, industries and regulators become increasingly aware of the benefits that can be had through recognition as well as the

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many ways in which recognition can be "managed" to alleviate their concerns over a general lowering of standards in their respective countries. Such a culture of mutual recognition would underscore the notion that recognition is a process not an outcome, and that it needs to be continually updated, reinforced and reappraised.

Ultimately, negotiators need to pay attention to conditions in individual sectors. MRA may not always be the best regulatory tool. MRAs are not always the best tool. They are time consuming, costly, difficult to implement and a sensitive issue for certain domestic regulators. As it stands the process of transatlantic recognition is already highly resource-intensive, and the future application of mutual recognition will need to be open to flexible and more creative arrangements in suitable sectors.

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Comments

Alasdair Young

Even though I am interested in the interaction of trade and regulatory policies, I have never found mutual recognition agreements (MRAs) very stimulating. They are extremely technical and there does not seem to be all that much actually happening. Nonetheless, they are something I feel I should know more about, so I welcomed the chance to bring myself up to speed by being forced to read a paper by (arguably) the two leading experts on transatlantic MRAs. That said, the paper did not challenge my prejudices. Note, however, that this is less to do with the paper than the subject.

I think that the framework for analysing MRAs according to four aspects—ex-ante equivalence; automaticity; scope; and ex-post guarantees—is extremely interesting and potentially very useful. I think that the framework (and the paper as a whole) would have been stronger if a distinction were drawn with regard to ex-ante equivalence between substantive regulatory requirements and conformity assessment processes. I find blurring this distinction to be a common shortcoming of work on MRAs and one that muddies the analytical waters (I return to this point later). I was disappointed that the framework was not explicitly applied to the section of the paper describing the state of play.

The section of the paper discussing the current state of play provided a useful overview of how things stand, but did not provide a systematic analysis of the different degrees of implementation. Table 1 suggests that the key variable determining whether an MRA will be implemented or not is the attitude of the relevant US regulatory agency. This, in turn, is attributed to a particular “regulator culture” in some agencies. Why does such a culture exist in some agencies and not

others? The text introduces a more nuanced picture, with additional variables—"bargaining power," industry attitudes; the regulatory role of US states; and the type of certification used—appearing in some of the stories, but not in others. The EU's internal preoccupations—enlargement and variation among member states—also popped up in some cases. It would have been helpful to have seen how all of these variables played out in each MRA. If the impact of "bargaining power," US regulatory agencies' attitudes and the role of the states in services regulation are to be isolated, comparison with the EU's MRAs with other countries would have been illuminating. Further, if we are to really understand what determines the success or failure of MRAs, it is important to address why MRAs are *not* attempted in some cases.

I also think the analysis would have benefited from being better contextualised in terms of a continuum of negative market integration. Market integration gets deeper as one moves from national treatment to mutual recognition of conformity assessment to negotiated mutual recognition of substantive requirements to the application of the mutual recognition principle. The vast majority of cases in the paper involve only mutual recognition of conformity assessment, although the architects agreement, if implemented, would represent negotiated mutual recognition of substantive requirements. My understanding is that the agreed, but not implemented, EU-US Veterinary Equivalency Agreement and the EU-Canada Trade and Investment Enhancement Agreement do so as well. In addition, the paper mentions, but does not really engage with, the approximation of substantive requirements through multilateral institutions (maritime safety); an example of positive market integration. Treating these different modes of market integration as discrete would have provided a foundation for a more nuanced analysis of the state of (and prospects for) transatlantic regulatory cooperation.

What strikes me is that the difficulty the EU and US have had in agreeing the mutual recognition of conformity assessments bodes ill for any deeper form of transatlantic regulatory cooperation.

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Chapter 8

Reconciling (or Failing to Reconcile) Regulatory Differences: The Ongoing Transatlantic Dispute over the Regulation of Biotechnology*

Gregory C. Shaffer
Mark A. Pollack

I. Introduction

In 1992, the US Food and Drug Administration (FDA) approved the first genetically engineered food—Calgene’s Flavr Savr Tomato—for sale and marketing in the United States. Encouraged by a regulatory system that treated genetically modified foods and crops as substantively equivalent to their conventional counterparts, US scientists have subsequently created, farmers have grown, and companies have marketed a wide range of genetically modified (GM) foods and crops. By the end of the 1990s, in “the most rapid adoption of a new technology in the history of agriculture,” some sixty percent of processed foods available in US groceries were derived from genetically modified organisms (GMOs) (Hill and Battle 2000).

By contrast with the US embrace of agricultural biotechnology, European publics and regulators at both the national and European Union (EU) levels have taken a far more cautious approach to GMOs, treating GM foods and crops as different from their conventional counterparts, and adopting increasingly strict and complex regulatory procedures for their approval and marketing. By the late 1990s,

* The authors are grateful to Timo Weishaupt for excellent research assistance.

these strikingly different regulatory approaches created serious obstacles to the export of agricultural products from the United States, and in turn raised the prospect of a major international trade war over the approval and marketing of GM foods and crops.

In this paper, we examine and bring up-to-date the story of the US/EU conflict over the regulation of agricultural biotechnology. The paper is organized in six sections. In section II, we outline briefly the respective regulatory systems put in place during the 1980s and 1990s by the US and the European Union, and we trace the emergence of the transatlantic regulatory dispute over GMOs. In section III, we examine the record of bilateral regulatory cooperation, including informal discussions among regulators, a formal Biotechnology Consultative Forum, and the activities of the transatlantic civil-society dialogues, all undertaken in an effort to find common - or at least compatible—grounds for biotech regulation. We note that none of these efforts has yielded formal regulatory agreements or even informal common understandings among US and European regulators. Next, we then look to the various multilateral forums—the World Trade Organization, the Biosafety Protocol signed at Cartagena in 1999, and the Codex Alimentarius Commission—noting that both the US and EU have attempted systematically to export their respective regulatory approaches to biotechnology in all three forums; the net effect of these efforts to date, however, has been to restate rather than resolve the fundamental conflict of regulatory approaches. In the fifth section, we turn back to the domestic level, examining the recent legislative and regulatory developments in the US and the EU, which we argue have produced, at best, modest evidence of convergence between the two systems. As we shall see, nearly a decade of dispute among the US and the EU has increased apprehension about GMOs, to a certain extent, in the United States, while leading to a greater emphasis on scientific risk assessment and a tentative resumption of approvals in the European Union. In both cases, however, the respective regulatory principles and procedures of the US and the EU have remained largely unchanged and starkly different. In light of these persistent differences, in May 2003 the United States brought a formal complaint before the World Trade Organization, examined in section VI of the paper. We elucidate the reasons why the US finally brought a WTO complaint after many years of restraint, analyze the claims made by the US in its complaint as well as EU responses, and we discuss the prospects for the complaint in the light of previous case-law as well as the EU's recent decision to resume approvals of new GM varieties. The final section concludes by arguing that, despite initial hopes, both bilateral and multilateral negotiations between the US and the EU have yielded little evidence of genuine deliberation or convergence, and that, despite obvious risks, the current WTO complaint offers the prospect of clarification and legal certainty for parties on both sides of the dispute.

II. Regulation of GM Foods and Crops: Two Regulatory Approaches

Genetic engineering, the process used to create GM seeds, crops, and the foods produced from them, is a technology used to isolate genes from one organism, manipulate them in the laboratory, and inject them into another organism. Supporters of agricultural biotechnology consider such genetic manipulation to be merely the latest step in an ongoing scientific process, from the farmer's "old-fashioned" selection of seeds and Mendelian cross-breeding to the mapping of plant and animal genetic codes. These supporters argue that the characteristics of these new plant varieties offer significant benefits to both producers and consumers. The benefits to producers have been most evident, as new GM varieties (such as Bt Corn, with its genetic resistance to the predatory corn borer, or Roundup-Ready soybeans, with their resistance to the commercial Roundup pesticide) can provide greater efficiency and lower costs in agricultural production. Direct consumer benefits, by contrast, have been less immediately evident, since the most common GM crops provide lower costs to farmers without any appreciable difference in the nature or quality of the product to the consumer; but in principle GM foods and crops could benefit human health by adding vitamins and nutrients to conventional crops, potentially resulting in products such as vitamin A-enhanced rice, "heart-friendly" oil and iron-enriched wheat.

Biotechnology's critics, by contrast, are often vociferous and have raised concerns over food safety, environmental harm, and ethics. Many opponents question the safety of GM foods, maintaining that they could encourage perverse selection for antibiotic resistance (through the consumption of foods with antibiotic marker genes) or trigger allergic reactions (though the ingestion of genes introduced from foreign species, such as peanuts). Environmental critics raise fears that the technology could lead to "super weeds," most notably through cross-pollination with pesticide-resistant GM crops. Some ethicists question the morality of mankind's manipulating genes, characterized by a statement by Britain's Prince Charles that the production of GM foods "takes mankind into realms that belong to God and to God alone."¹

Crucially, we argue in this paper, the regulation of biotechnology is also a question about the *regulation of risk under uncertainty*, pitting against each other not only specific regulatory standards but broader regulatory systems that deal with the risk posed by GM foods and crops in distinctively different ways. Risk, in this context, refers to "the combination of the likelihood (*probability*) and the harm (*adverse outcome*, e.g. mortality, morbidity, ecological damage, or impaired quality

1 Kevin Cullen, "Genetically Modified Food Fight Growing Unpalatable," Boston Globe, August 3, 1999, at A1 (citing Prince Charles). See also Thompson 2003:14.

of life) resulting from exposure to an activity (*hazard*)” (Wiener and Rogers 2002: 320, emphasis in original). In principle, therefore, regulators faced with a novel product or process—such as the genetic modification of foods and crops—need to ascertain the potential harm caused by such activities, as well as the probability of such harm, in order to take a decision on the legality or illegality of that product or process.

In practice, however, risk regulation frequently requires regulators to act in the face of *uncertainty* regarding the nature and extent of the risks posed by new products and processes, raising the fundamental political question of how governments should regulate risk in the face of such uncertainty. Frequently, when faced with uncertainty about risks, regulators take *precautionary* measures, regulating or even banning certain products or activities even in the absence of complete information about the risks posed by them. More specifically, Giandomenico Majone (2003a: 18-26) argues, government regulators in the United States and other jurisdictions have responded in four distinct ways—prohibitions, least feasible risk, elimination of significant risk, and cost-benefit analysis—with a general trend over time from the first and least sophisticated to the fourth and most sophisticated approach. In the first of these approaches, regulators exercise a high degree of precaution by simply banning any product (e.g. food additives) that can be shown to pose some level of risk to human health (e.g. carcinogens). While clearly motivated by a concern for human health, such outright bans ignore the potential societal benefits of the banned products, as well as the probability of risk posed by a given product, which in the case of carcinogens can run the gamut from significant to minor. For this reason, regulators in the United States and elsewhere have moved over time towards other, less blunt approaches toward the regulation of risk.

According to Majone’s second principle of “least feasible risk,” for example, regulators are required to set standards that minimize risk “to the extent feasible.” This is a more discriminating standard than outright prohibition, but it begs the question of technological or economic feasibility, and once again makes no distinction between significant and minor risks. For this reason, US lawmakers, regulators and courts moved during the 1970s and 1980s toward a third approach, in which the goal of regulators was not to eliminate *all* risk but rather *significant* risks, which in turn would require regulatory agencies to engage in scientific (and typically quantitative) risk assessments as the basis for new risk regulations. Fourth and finally, Majone argues, this gradual process of policy learning culminated in the use of cost-benefit analysis as the basis for all risk regulation. Such an approach involves not only the use of scientific risk assessments as the basis for assessing the risk of a new product or process, but also the economic calculation of the potential costs and benefits of proposed regulations, which would be adopted only if the net benefits to society from those regulations exceeded their costs. In the space of some three decades, Majone concludes, American policymakers, regulators and courts

have progressed to a sophisticated approach to risk regulation, relying on scientific assessments of risk as well as economic assessments of costs and benefits —“an outstanding, and in many respects unique, case of policy learning” (Majone 2003a: 26).

While a useful heuristic device to understand the range of possible approaches to regulating risk under uncertainty, Majone’s classification scheme simplifies a complex US response to risk, which even today combines elements of all four approaches under different laws and in different issue-areas. Even more importantly for our purposes, Majone’s ideal-typical progression fails to capture parallel developments in Europe, where risk regulation took place largely within national contexts until the 1980s, when EU institutions began to play an increasing role in harmonizing risk regulation across the EU’s various member states. In the EU context, David Vogel (2001) and others have argued, Europe’s approach to risk regulation has evolved quite differently than in the United States: whereas the former began with highly precautionary legislation in areas like the environment, consumer protection, and worker health and safety, only to adopt scientific risk assessment and cost-benefit analysis more recently, in Europe regulators have arguably become more precautionary and more risk-averse over time.² In effect, Vogel writes, US and EU risk regulation resemble “ships passing in the night,” with the EU becoming more precautionary and the US less precautionary over time. A central cause of this increasingly precautionary approach, Vogel and others argue, has been the long series of European regulatory failures and crisis over the past several decades, including most notably the BSE or “mad cow” crisis discussed below. As we shall see, these crises have weakened public trust in EU regulators and scientific risk assessments, increased support for highly precautionary regulations, and called into question the *legitimacy* of EU regulations and EU institutions in European public opinion. Responding to this crisis of legitimacy, EU institutions have moved aggressively to overhaul EU risk regulation across a range of areas, adopting strict new regulations for products and processes like genetically

2 “Between the 1960s and the 1990s,” Vogel writes, “a number of US regulations were more stringent, innovating and comprehensive than those adopted by European countries and the EC/EU. However, since the mid 1980s, this pattern has changed. Now in a number of significant areas of regulatory policy, EU regulations are more stringent, innovative, and comprehensive than those adopted by the US. Prior to the mid 1980s, US policy-makers identified more products and processes as posing unacceptable risks to public health or the environment than did regulatory authorities in Europe. Now the latter regard a number of products and processes as posing unacceptable risks to consumers and the environment that US policy-makers do not. Since the mid 1980s, the political influence of constituencies favoring more risk averse regulatory policies have strengthened in Europe while since the early 1990s it has declined in the US. Likewise, since the mid 1980s regulatory politics and issues have become more politically salient in Europe, while since the early 1990s, they have declined in the US” (Vogel 2001 at 2-3).

modified foods and crops and elevating the “precautionary principle” to the status of doctrine in EU regulation.³

Other scholars dispute Vogel’s “ships passing in the night” characterization of US and EU risk regulation, noting that the purported “flip-flop” in US and EU approaches to risk regulation draws disproportionately from a few controversial issue-areas such as the use of growth hormones in beef cattle and the regulation of GMOs. In a wide-ranging survey of US and European risk regulation, Wiener and Rogers (2002) find a more complex set of outcomes, in which the US is more precautionary in some areas (e.g. nuclear energy, particulate air pollution) while the EU demonstrates greater precaution in others (e.g. GMOs, hormone-treated beef). “This broader analysis indicates that neither the US nor the EU is a more precautionary actor across the board, today or in the past. Relative precaution appears to depend more on the particular risk than on the country or the era” (Wiener and Rogers 2002: 322-23).

For this reason, we resist extrapolating from our study of GMO regulation to the question of comparative precaution more generally, but we do emphasize the difficulty of biotechnology regulation *qua* risk regulation, which raises distinctive questions at the domestic level and in the context of international trade, environmental, and food-safety law.⁴ In any event, as we shall see, the United States and the European Union have taken starkly different approaches to the regulation of biotechnology, with the US opting in large part for science-based regulation undertaken largely by relatively independent regulatory agencies that have treated GM products as substantively similar to conventional foods; while the EU has adopted and elaborated a distinctive and separate system of approval and labelling for GM products system based on risk management by political bodies that take into account social and economic concerns as well as scientific risk assessment. These very different approaches to biotech regulation—reflecting different cultural attitudes toward food and agriculture, underlying differences in regulatory style, pressures from private interests, and contingent events such as the EU’s food-safety scandals of the 1990s—have in turn created significant trade frictions between the US and the EU, as we shall see below.

A. Regulating Biotechnology in the United States

Genetic modification and GMOs first became a concern for national and international regulators in the 1970s, as biological scientists began making

3 The literature on the precautionary principle in risk regulation has mushroomed in recent years: for a range of supportive and critical views, see e.g. Bodansky 1991; Cameron and Abouchar 1991; European Commission 2000; Wiener and Rogers 2002; and Majone 2003b.

4 On risk regulation and EU governance, see e.g. Neyer 2000; Vos 2000; Joerges 2001b; Vogel 2001; Abels 2002; Chalmers 2003; Majone 2003b.

fundamental advances in recombinant DNA (rDNA) research.⁵ The debate over the regulation of such research is often dated to the international meeting of scientists at Asilomar, California, in 1975, which pointed to the promise of biotechnology but also called on the scientific community to exercise caution and restraint in the creation of genetically engineered organisms that might prove hazardous. In the United States, the Asilomar conference triggered a national debate over the regulation of biotechnology, with a number of Congressional representatives introducing legislation that would ban or regulate rDNA research. At the same time, the National Institutes of Health (NIH) created a Recombinant DNA Advisory Committee, which in June 1976 put forward a set of guidelines for rDNA research in the United States. By the late 1970s, initial public fears about the biohazards of laboratory biotech research had abated somewhat, and the US had meanwhile emerged as a world leader in biotechnology research. This led to strong support in the US Congress and the executive branch for a regulatory system capable of ensuring the safety of biotechnology research while at the same time encouraging the development of a potentially important high-tech sector.

In 1986, after public notice and comment, the Office of Science and Technology Policy (OISP) in the Reagan Administration issued a "Coordinated Framework for the Regulation of Biotechnology" that continues to shape US biotech regulation to this day. Crucially, the OISP concluded that the techniques of biotechnology are not inherently risky and that biotechnology could therefore be adequately regulated by existing federal regulators under existing statutes, obviating the need for new and dedicated legislation applying specifically to genetically modified organisms. More specifically, the Coordinated Framework establishes a division of responsibility among the three primary US regulators, with the Food and Drug Administration (FDA) serving as the primary regulator of GM foods, while the United States Department of Agriculture (USDA) and the Environmental Protection Agency (EPA) are charged with supervision of the planting of GM crops and the environmental impact of GMs with pesticidal characteristics.⁶

The Pure Food and Drugs Act (later expanded to the Federal Food, Drug and Cosmetic Act) delegates the primary responsibility for food safety regulation to an independent agency, the Food and Drug Administration (FDA), which is authorized to inspect, test, approve, and set safety standards for foods, drugs, chemicals, cosmetics, and household and medical devices. Faced with the first applications

5 This section draws liberally from Lee Ann Patterson's (2000: 319-32) analysis of the early history of EU biotech regulation, as well as from Cantley's (1995) detailed study.

6 For an excellent and up-to-date summary of the US system, see Pew Initiative on Food and Biotechnology (2004). As the report (2004: 3) points out "The Central Premise of the Coordinated Framework is that the process of biotechnology itself poses no unique risks and that products engineered by biotechnology should therefore be regulated under the same laws as conventionally produced products with similar compositions and intended uses."

from producers for the licensing of GM foods and crops, the FDA decided in 1992 (and reaffirmed in 2001) that GM foods were not substantially different than regular foods, and that it would therefore approve foods based on the health risks of the individual product, and *not* the process by which it is produced. In 1992, the FDA also ruled that neither any pre-market approval process nor any specific labelling would be required for genetically modified foods that were "substantially equivalent" to conventional foods and thus "generally recognized as safe" (GRAS).⁷ Pre-market approval is only required by the FDA for products where the genetic manipulation has altered the substance and safety of the product (for example, by introducing new allergenic properties or changing the nutritional content of the food in question), in which case it is regulated as a "food additive."⁸ Since the FDA made this determination, it has approved all subsequent genetically modified varieties without any labelling requirement. While the FDA would later prepare guidelines for manufacturers wishing to *voluntarily* label their foods either containing or not containing bioengineered ingredients, there remains at this writing no requirement for consumers to be informed that foods may contain such ingredients (Cantley 1995: 566-73; Echols 1998: 538; Stewart and Johanson 1999: 248-49).

Parallel to the FDA's activities, two other agencies play important roles in the regulation of agricultural biotechnology in the United States. The USDA's Animal and Plant Health Inspection Service (APHIS) regulates the release of new GM crops, which the agency categorizes as potential plant pests, into the environment. In practice, APHIS requires the developers of such crops to notify the agency of field trials or obtain a license to conduct them, and the agency has licensed some 10,000 field trials of new GM varieties as of 2004. APHIS may also issue a finding that a given GM variety is not, in fact, a plant pest, and deregulate the crop for planting without restriction (a step taken for 61 varieties by 2004).⁹ The Environmental Protection Agency, finally, has responsibility under the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA) for regulating the use of pesticides, including genetically modified plant-incorporated protectants (PIPs) such as Bt corn, which incorporates resistance to pests as a result of genetic modification (Taylor 1996; EPA 2003, Young 2003).¹⁰ The EPA, like the FDA, operates as an independent regulatory agency, while the USDA is a cabinet office under the

7 See FDCA § 409; 21 USC § 348.

8 Pew Initiative 2004:14. Pre-market approval, however, is required by the EPA for products with bioengineered pesticidal characteristics, as noted above.

9 *Ibid.*, p. 8; see also US Mission to the European Union, "USDA Announces First Steps to Update Biotech Rules," <http://www.useu.be/Categories/Biotech/Jan2204USUpdateBiotechRules.html>, accessed on 11 June 2004.

10 For a complete list of PIPs registered with the EPA, see the EPA website at http://www.epa.gov/pesticides/biopesticides/reg_of_biotech/eparegofbiotech.htm, accessed on 11 June 2004.

Reconciling (or Failing to Reconcile) Regulatory Differences...

leadership of the Secretary of Agriculture; all three of these regulators, moreover, are subject to the extensive administrative law requirements of the US Administrative Procedure Act, requiring prior notice and comment of all proposed regulations, which are also subject to judicial review before federal courts. More generally, the US system has been characterized by strong federal institutions, significant independence of regulators from political pressures, extensive reliance on scientific risk assessment in regulatory decisions, and industry self-regulation, all of which stand in stark contrast to the historically decentralized and increasingly politicized food safety system of the European Union. This remains the case despite some degree of administrative fragmentation among the three lead agencies and some concern about gaps in the regulatory framework under existing US legislation.

B. Regulating Biotechnology in the European Union

The 1957 Treaty of Rome establishing the European Community made no explicit mention of an EU policy for biotechnology, or even for the closely related areas of environmental and food-safety policy, which remain primarily a national responsibility within each of the 15 member states. Nevertheless, just as the federal government in the United States used its interstate commerce authority to regulate food safety in the early 20th century, so the Union has developed a *de facto* policy on biotechnology over the past three decades, as the EU's policies on agriculture and the establishment of an internal market for biotech products have "spilled over" into the regulation of the content and labelling of European food products. By comparison with the United States, however, EU regulation of biotechnology remained a much less centralized and incomplete regulatory patchwork, with a decision-making process in which the key decisions were taken not by a specialized regulatory agency like the FDA, but by political bodies such as the Council of Ministers, Commission, and European Parliament, in an uneasy cooperation with competent authorities in each of the member states.

The first comprehensive legislation for the regulation of biotechnology in the EU came in 1990, with the adoption of two directives by the EU Council of Ministers: Directive 90/219 on the Contained Use of Genetically Modified Microorganisms, which regulates the use of GMOs in laboratory settings, and Directive 90/220 on the Deliberate Release into the Environment of Genetically Modified Organisms, which governed for over a decade the approval, planting, and marketing of GM foods and crops within the Union and is therefore particularly important for our purposes here.

The Commission's (1988) proposal for a "deliberate release" Directive began by noting the extraordinary diversity of existing national regulations across the various member states, including: (a) a ban on deliberate release (subject to exceptions) in Denmark and Germany; (b) a case-by-case approach to the release of individual GMOs in a number of member states (UK, France, Belgium, Netherlands, and

Luxembourg); and (c) an absence of legislation in other member states (Ireland, Greece, Italy, Spain, and Portugal).¹¹ The Commission's proposal emphasized the scientific uncertainty associated with genetic engineering, and therefore proposed an EU regulatory scheme that would provide for case-by-case assessment and authorization of the release of all new GM varieties into the environment. Hence, by contrast with the US FDA, which elected to regulate GM foods only in terms of their final characteristics as *products*, the European Union elected from the outset to apply distinctive regulations to GM foods as a function of the *process* through which they were developed.

More specifically, the Commission's proposal would require any individual wishing to release GMOs into the environment (e.g. for farming or marketing) to notify and provide a detailed risk assessment to the competent regulatory authority of the EU member state in which the release was proposed. That member state would then be charged with evaluating the application in line with the provisions of the directive. If the member state rejected the proposal, the procedure would end, but if the member state accepted the proposal, the dossier would then be forwarded to the Commission and to the other member governments, which would have a limited period to object to the authorization. If no objections were put forward, the product would be authorized for release and/or placement on the market throughout the EU. By contrast, if one or more member governments or the Commission objected, the Commission would then undertake its own assessment and formulate a decision to approve or deny the application. The Commission's draft decision would be circulated to an advisory committee of member-state representatives, of whose opinion the Commission would have to take "utmost account;" the final decision, however, would remain with the Commission. In a final acknowledgement of member-state prerogatives, however, the Commission proposed a "safeguard procedure" whereby a member state could, if it had evidence of a serious risk to people or the environment from a previously approved GMO, "provisionally restrict or prohibit the use or sale of that product on its territory." Once again, however, the member state in question would have to inform the Commission of its actions and give reasons for its decision, and the Commission would retain the power to approve or reject the measures in question.

The European Parliament—which has emerged as a consistent champion of strict regulation of biotechnology over the past two decades—criticized the Commission proposal as being too lax on a number of points, and proposed a number of amendments that would have substantially tightened regulatory restrictions on the approval of new GMOs. The US government, by contrast, criticized both the Commission proposal and the Parliament's proposed

¹¹ See also European Parliament 1989, Cantley 1995, and Patterson 2000 for good discussions of existing national regulations.

amendments as unnecessarily strict and arbitrary, particularly insofar as they proposed to regulate all GMOs regardless of the characteristics of the products to which they gave rise.¹²

The Council of Ministers followed the broad lines of the original Commission proposal, thus rebuffing the core US objections, while at the same time rejecting the Parliament's most far-reaching amendments. The Council did, however, modify the procedure whereby the Commission could issue approvals for new GM varieties: Whereas the original text provided for the Commission decision to be subject only to an advisory committee of member-state representatives, the final text featured a more constraining "regulatory committee," which could approve a draft Commission decision by a qualified majority vote. If the regulatory committee did not approve the decision, however, it was to be sent to the Council of Ministers, which could approve the Commission decision by qualified majority or reject it by a unanimous vote. If the Council failed to act within three months, the directive provided that "the proposed measures shall be adopted by the Commission" (Article 21). Finally—and significantly, in light of later developments—the Council retained a slightly modified version of the Commission's safeguard clause, whereby a member state could, on the basis of new evidence about risks to human health or the environment, "provisionally restrict or prohibit the use and/or sale of that product on its territory" (Article 16). The member state in question would be required to inform the Commission, which would approve or reject the measures in cooperation with the regulatory committee mentioned above.¹³

In 1997, the regulatory structure of Directive 90/220 was supplemented by Regulation 258/97, the so-called Novel Foods Regulation.¹⁴ According to the terms

12 "By basing the Directive on the technique by which the organism is modified, the EC is regulating organisms produced by a given process. This is not a functional category directly related with the characteristics of the organism. As expressed in the US coordinated framework for the regulation of biotechnology, the US generally regulates products rather than the process by which they are obtained. We are concerned whether differences in approaches and their implementation may lead to difficulties in our attempts to achieve international harmonization. It is important to understand that whether an organism is 'unmodified' or 'genetically modified' is, in itself, not a useful determinant of safety or risk." US Government, "International Harmonization in the Biotechnology Field," 7 July 1989, quoted in Cantley 1995: 559.

13 Council Directive 90/220/EEC of 23 April 1990 on the deliberate release into the environment of genetically modified organisms, *Official Journal of the European Communities* L117 of 08/05/1990, pp. 15-27.

14 Regulation (EC) No. 258/97 of the European and of the Council of 27 January 1997 Concerning Novel Foods and Novel Food Ingredients, *Official Journal* L 043, 14/02/1997, pp. 1-6. For excellent analyses of the regulation, see also Hunter (1999: 217-225) and Commission of the European Communities, "Novel Foods and Novel Food Ingredients," <http://europa.eu.int/scadplus/leg/en/lvb/l21119.htm>, accessed on 11 April 2004.

of the regulation, "novel foods" were defined as all foods and food ingredients that had "not hitherto been used for human consumption to a significant degree within the Community" and included both foods that had been genetically modified as well as foods produced from, but not containing, GMOs (for example, oils processed from genetically modified crops but no longer containing any traces of GM material).¹⁵ The regulation established an authorization procedure similar to that of Directive 90/220, as well as labelling requirements for all approved GMOs used in food and foodstuffs. Significantly, however, the regulation also went on to provide a simplified regulatory procedure for foods derived from, but no longer containing, GMOs, provided that those foods remained "substantially equivalent" to existing foods in terms of "their composition, nutritional value, metabolism, intended use and the level of undesirable substances contained therein." Such a determination would be made by the competent authority in the member state receiving the application, and would be notified to the Commission, which would in turn notify the other member states. In practice, this provision would prove to be significant in the coming years, as member states would approve a number of products as being "substantially equivalent" to their conventional counterparts.¹⁶

Finally, and again significantly in terms of later developments, the regulation (like the earlier Directive 90/220) contained a safeguard clause allowing member states, "as a result of new information or a reassessment of existing information" to "temporarily restrict or suspend the trade in and use of the food or food ingredient in question in its territory" (Article 12). Once again, any member state invoking such safeguards would be required to inform the Commission, giving the grounds for its decision, and the Commission would rule on the legality of the safeguard in cooperation with the Standing Committee on Foodstuffs.

By comparison with the US system, the regulatory structure established by Directive 90/220 and Regulation 258/97 was more complex, more decentralized, and more politicized than the US system, with more potential "veto players" capable of blocking the approval of new GM varieties or even the release and marketing of EU-approved varieties (Young 2003: 465). In practice, moreover, the implementation of the new regulations became inextricably and controversially linked to a series of food-safety scandals that rocked the Union during the 1990s, most notably the BSE scandal that struck in 1996. In March of that year, the British government of Prime Minister John Major revealed a possible connection between

15 The regulation would not apply to food additives, flavorings, or extraction solvents, governed by other EU legislation (Article 2).

16 By contrast, no products consisting of or containing live GMOs have been authorized under the terms of the Novel Foods Regulation at this writing. See Commission of the European Communities, "Question and Answers on the Regulation of GMOs in the EU," MEMO/02/160-REV of 4 March 2003.

Creutzfeldt-Jacob Disease, a fatal disease for humans, and bovine spongiform encephalopathy (BSE), a disease spread among cattle through their consumption of contaminated feed, popularly known as "mad cow disease." The BSE outbreak infected some 150,000 cattle in the UK, triggering a wide-scale slaughter of cattle, a Community ban on the export of British beef, a plummet in beef sales throughout Europe, and a loss of consumer confidence in regulatory officials. The crisis did not abate quickly, moreover, with France and Germany reporting new outbreaks of the disease in 2000 and 2001. Perhaps most importantly for our purposes, the BSE scandal raised the question of risk regulation "to the level of high politics, and indeed of constitutional significance" (Chalmers 2003: 534-538), generating extraordinary public awareness of food safety issues and widespread public distrust of regulators and scientific assessments.¹⁷

It was in this socio-political context that genetically modified crops were first commercially introduced in the United States and Europe. In April 1996, within a month of the ban on British beef, the Commission approved the sale of genetically modified soy products over member state objections. In November 1996, GM soy was imported from the United States to the EU, spurring widespread protest by Greenpeace and other groups. Soybeans are ingredients in more than half of processed foods, and the US shipped between 25 and 40% of its soybeans to the EU (Vogel 2003: 10). In short, widespread media coverage and public debate about GM foods began just as the BSE food crisis struck, which helped link the two issues before the European public (Ansell et al. 2003).¹⁸

Two other events occurred in late 1996 that add important context to the contestation that was to engulf EU decision-making over GMOs. In December 1996, a Scottish scientist announced to the world the first successful reproduction of a cloned mammal, a sheep named "Dolly," suggesting that the cloning of humans could follow shortly. The announcement spurred ethical challenges to biotechnology research. Also in December, the United States and Canada lodged

17 A study showed that around 90% of US citizens believed the US Department of Agriculture's statements on biotechnology, whereas 12% of Europeans stated that they trusted national regulators. See Vogel 2003, citing J. Enriquez and R.A. Goldberg, "Transforming Life, Transforming Business: The Life Science Revolution, Harvard Business Review, Mar.-Apr. 2000, published at <http://www.hbsp.harvard.edu/products/hbr/marapr00/R00203.html>. Vogel notes that, in the BSE scandal, "the European Commission had relied on the advice of the Scientific Veterinary Committee, which was chaired by a British scientist and primarily reflected the thinking of the British Ministry of Agriculture, Fisheries and Food—advice which subsequently proved flawed." Id. at 27.

18 To give just one example of this pattern, the *European Voice* published two half-page articles under the topic "Survey: Consumer Protection" in its weekly edition of April 13, 2000. The article on the top half of the page is entitled "Spate of health scares pushes food safety to top of the EU agenda," while that on the bottom half is entitled "Union faces dilemmas as it debates new GMO rules." See *European Voice*, 13-19 April 2000, at 15.

complaints before the World Trade Organization challenging the EU's ban on hormone-treated beef on the grounds that the EU ban constituted a disguised barrier to trade and was not scientifically justified. The WTO judicial bodies subsequently held against the EU, and, when the EU failed to comply with the ruling, authorized the United States and Canada to adopt retaliatory tariffs on EU farm products, leading in turn to widespread protests among European farmers and anti-globalization activists (see below).

The close succession of these events illustrates how the popular understanding of GM products in Europe became associated with consumer anxieties related to food safety crises, distrust of regulators and scientific assessments, disquiet over corporate control of agricultural production, ethical unease over genetic modification techniques, environmental concerns, and anger over the use by the United States of international trade rules to attempt to force "unnatural" foods on Europeans. A widespread cross-sectoral movement organized to oppose GMOs in Europe, bringing together environmentalists, consumers, and small farmers. The movement operated at multiple levels, working the media and local and national political processes, coordinating transnationally, and lobbying the Commission and EP (Ansell et al 2003). The British media dubbed GM products "Frankenstein" foods, playing off fears that scientists and public officials could not control the release of GM products. European negative attitudes toward GM crops and foods rose rapidly. In early 1996, 46% of the French were against GMOs, a figure that rose to 65% in 1999, and 75% in 2002. Similarly, over 80% of Germans expressed negative opinions about GMOs in late 1998 (Gaskell, Allum, and Stares 2003).

In the midst of the fray, the Commission approved the sale of another GM food crop (Bt corn) in January 1997, over the objection or abstention of all but one of the fifteen member states (Bradley 1998). The Commission was able to do so because of the approval procedure set forth in Directive 90/220. As we saw, a member state (in this case France) could approve a GM variety and forward its decision to the Commission and the other member states so that the variety could be marketed throughout the EU. Since some member states objected to this approval, the Commission reviewed the dossier, which it did favourably. The Commission then submitted a draft authorization to the regulatory committee consisting of a representative from each member state. Eight member state representatives on the committee abstained or voted against the approval, so that the Commission forwarded its proposal to the Council (operating as the Environment Council). However, the Council could only amend the Commission's proposal by a unanimous vote, and France announced that it supported the Commission's authorization (Bradley 1998, 212). As a result, even though fourteen member states refused to support the Commission, the approval went forward.

The member states did not simply accept the Commission's decision. They undermined its implementation, invoking the safeguard clause of Directive 90/220

which allowed a member state could prohibit an approved GM variety in its territory if it had "justifiable reasons to consider that [the] product [...] constitutes a risk to human health or the environment." Austria was the first act, promptly prohibiting the cultivation and marketing of the GM maize variety on February 14, 1997. Luxembourg followed suit on March 17. Over time, moreover, member-state deployment of safeguards bans grew, undermining the central purpose of Directive 90/220 to create a single market for GM crops under a harmonized regulatory system. By January 2004, nine member-state safeguards, applied by Austria, France, Greece, Germany, Luxembourg, and the United Kingdom, were in effect (European Commission 2004b). The Commission forwarded to the regulatory committee a proposal to initiate a legal challenge against these member state bans, but proceeded no further when the committee refused to support it.

Opponents of GMOs worked not only the political process, they took their battle to the marketplace as well. Under pressure from potential consumer boycotts of their foods, many large European retailers refused to buy or sell GM foods. The EU trade association EuroCommerce demanded that US producers and distributors segregate and label GM soybeans. Major purchasers of soybean imports into the EU, such as Unilever, simply refused to buy US soybeans (Vogel 2001: 10). Monsanto organized a media campaign to raise support for GM products, but the campaign backfired, having served primarily to increase public awareness that GM food products had arrived or were on their way. Surveys in the UK and France indicated that negative perceptions of GMOs rose following the Monsanto advertising campaign (Vogel 2001: 12). Thus, although GM soy and maize varieties had been legally authorized for marketing throughout the EU and validated by risk assessments conducted by EU scientific committees,¹⁹ they were subject to member state bans and were barely commercialized at all (Vogel 2001: 11).

Responding to the popular backlash against GMOs, a group of member states pronounced in June 1999 the need to impose a moratorium on approvals of GM products, pending the adoption of a new and stricter regulatory system, including provisions regarding the labelling and traceability of GM food and crops "from farm to fork."²⁰ Since the earlier date of October 1998 (when two GM varieties of

19 The Scientific Committee on Plants issued 16 favorable opinions on applications for placing GM plant varieties on the market under Directive 90/220/EEC, and only one unfavorable opinion "due to an insufficient risk assessment," resulting in the withdrawal of the application. See Commission memo/02/160, Oct. 15, 2002 (questions and answers on the regulation of GMOs in the EU).

20 In an annex to the press release of the Environment Council meeting in Luxembourg on June 24/25 1999, the Danish, French, Greek, Italian and Luxembourg delegations declared: "The Governments of the following Member States (Denmark, Greece, France, Italy and Luxembourg), in exercising the powers vested in them regarding the growing and placing on the market of genetically modified organisms (GMOs), [...] point to the importance of the

carnations were approved), no GM varieties had been authorized for sale in the EU market, the only exception being for foods derived from GM varieties deemed "equivalent" to traditional foods under the 1997 Novel Foods Regulation. For the next five years, a blocking minority of member governments within the Council would obstruct the authorization of any new GM variety, pending the adoption of a revised EU regulatory framework (see below).

By the late 1990s, then, the US and the EU had adopted significantly different regulatory standards and distinct regulatory *systems*, summarized in Table 1 (adapted from Young 2003). By contrast with the US system, predicated on science-based decision-making conducted largely by independent regulatory agencies, the EU system featured decision-making by political bodies based on criteria that included social and economic considerations alongside scientific ones. In practice, these distinctive regulatory systems were reflected in different regulatory standards, with more rapid approvals and less onerous restrictions in the US case than in the EU.

The impact of the EU's moratorium and its stricter standards was felt almost immediately in the United States, where around two-thirds of all GM crops are grown. US exports of soy to the EU were valued at \$1.5 billion in 1998, about thirteen times the value of lost beef sales to the EU in the earlier WTO dispute, but these sales have since fallen by over \$400 million.²¹ Moreover, the use of GM varieties developed and patented in the United States was spreading to other countries, including such leading agricultural producers as Argentina, Australia, Brazil, and China, increasing the profit potential for US biotech firms. In light of the growth and prospects of agricultural biotechnology for US farmers and industry, their trade associations pressured US authorities to challenge European trade restrictions bilaterally and under WTO rules. The Clinton and later the Bush Administrations initially resisted these pressures for litigation, fearing a populist backlash among European consumers, yet these demands remained and grew increasingly vocal as the EU moratorium continued through five successive years (Pollack and Shaffer 2001).

(contd.)

Commission submitting without delay full draft rules ensuring labeling and traceability of GMOs and GMO-derived products and state that, pending the adoption of such rules, in accordance with preventive and precautionary principles, they will take steps to have any new authorizations for growing and placing on the market suspended." Council of Ministers. 2194th Council meeting - Environment - Luxembourg, June 24-25, 1999, Press 203, Nr 9406/99.

- 21 See United States Department of Agriculture, Foreign Agricultural Service, Bico Commodity Aggregations, March 20, 2004 (noting decline of US soy imports into the EU from US\$1.534 billion in 1998 to US\$1.113 billion in 2003. Available on-line at <http://www.fas.usda.gov/ustrdscrip/USReport.exe> (visited March 20, 2004).

Table 1
Summary of US and EU Approaches to Biotechnology Regulation

	<i>Aspect</i>	<i>US</i>	<i>EU</i>
	View of biotech	Substantially equivalent	Inherently different (de facto)
	Approach to risk management	Sound science	Precautionary principle
	Decision-making style	Administrative	Political (de facto)
	Pre-release notification	Field tests – mandatory	
		Pesticides – mandatory	Mandatory
		Foods – voluntary if GRAS	
	Approval required	Field tests – yes	
		Pesticides – yes	Yes
		Foods – no if GRAS	
	Labelling	Only in specific instances	Mandatory

Source: Abbreviated from Young 2003: 466

Caught in the middle between member governments intent on ever-stricter regulations on the one hand, and a US criticizing the moratorium and the proposed regulations on labelling and traceability on the other, the Commission pursued a dual-track strategy, proposing a series of new EU regulations to satisfy member-state demands while calling repeatedly for a resumption of GM approvals by the EU. This campaign would finally bear fruit in 2004, when the Commission approved the first new GM variety to be licensed in the EU since 1998. In the meantime, however, the transatlantic dispute over biotechnology regulation threatened to escalate into a full-blown trade war, spurring repeated attempts by the two sides to resolve their differences in bilateral or multilateral forums.

III. The NTA and Bilateral Regulatory Cooperation

As it happens, the emergence of the transatlantic biotechnology dispute coincided with the establishment of the New Transatlantic Agenda (1995) and the Transatlantic Economic Partnership (1998), both of which represented efforts by

Washington and Brussels to deepen their economic ties and to address long-standing trade tensions. One of the core elements of the NTA and TEP programs was the establishment of informal and (increasingly) formal regulatory cooperation between US and EU regulators in various issue-areas (Pollack 2003). As early as 1991, the Commission Directorate-General for Competition signed a regulatory cooperation agreement with the US Federal Trade Commission and the Department of Justice, instituting an ambitious and largely successful program of day-to-day cooperation and information-sharing in cases of mutual interest. Later, the US and EU established formal Mutual Recognition Agreements in half a dozen economic sectors, in which the EU and the US would recognize the validity of each others' testing and certification procedures, and additional cooperation agreements were to follow in other issue-areas such as data privacy, where the US/EU Safe Harbour Agreement provided an innovative mechanism whereby US firms could be certified as meeting the EU's more demanding data-privacy requirements (Shaffer 2003).

In the context of the NTA and the TEP, biotechnology was quickly identified as an area in which a structured dialogue among regulators might build mutual understanding and trust, provide early warning of disputes, and perhaps in time contribute to a gradual convergence of regulatory approaches to GM foods and crops. Throughout the late 1990s, therefore, the US and EU established numerous working groups of technical transgovernmental and scientific experts to exchange information relating to GMOs.²² For example, the 1995 New Transatlantic Agenda set up a High Level Environment Consultation Group which was to work in conjunction with a Permanent Technical Working Group. The latter was to bring together representatives from the EU's Environment and External Relations Directorates-General and from the Office of the United States Trade Representative, the Environmental Protection Agency and the US Department of Agriculture. This group was soon complemented by two new groups focusing on information exchange over biotech issues: the Agrifood Biotech Group (which consisted of governmental representatives from the Commission's agricultural and industry directorates-general and the US Department of Agriculture and USTR) and the US-EC Task Force on Biotechnology Research (which coordinated workshops bringing together US and European scientists). Then, in connection with the 1998 Transatlantic Economic Partnership, the two trading partners set up yet another group—the TEP Biotech Group—to coordinate discussions and information-

22 The US Congress had, a few years earlier, explicitly amended the Federal Food, Drug and Cosmetics Act to instruct the FDA "to move toward the acceptance of mutual recognition agreements relating to the regulation of drugs, biological products, devices, foods... between the European Unions and the United States." *See* FFDCFA, 21 USC 383(c)(2) (1994).

exchange, this time focusing on the trade effects of each side's regulation of agricultural biotechnology.²³

By and large, however, the output of these working groups was considered disappointing by both sides.²⁴ Despite years of regular dialogue, the two sides never progressed to a formal cooperation agreement in the biotech sector; nor was there any clear sign of convergence in the views of US and EU regulators as a result of their dialogue. In 1999, for example, Commission officials consulted widely with their US counterparts in designing the fledgling European Food Safety Authority, examining the structure and procedures of the FDA closely as a potential model; the Commission's eventual proposal for the EFSA, however, drew at best selectively on the FDA model, accepting the role of independent agencies in scientific risk assessment, but insisting that risk management continue to be undertaken by political bodies such as the Commission, Council, and European Parliament.²⁵ The FDA and the Commission therefore remained very different types of regulators guided by distinctive mandates, with the FDA in particular refusing to consider any serious challenge to its model of independent and science-based decision-making (which US officials privately referred to as the "gold standard" of biotech regulation), and the Commission politically unable or unwilling to move towards a truly independent regulatory agency along the lines of the FDA.

As little progress was made among US and EU governmental representatives, the US and EU decided to form two transatlantic civil groups in November 1999: a transatlantic scientific advisory committee consisting of scientists specifically working on genetically modified organisms, and an EU-US Biotechnology Consultative Forum composed of twenty independent experts charged with examining the issues posed by biotechnology for regulators on both sides of the Atlantic. In the optimistic words of acting EU ambassador to the US John Richardson, these groups could help forge "a transatlantic consensus on where we go with biotechnology in the future" (Yerkey 1999: 2025). The Consultative Forum issued its final report, a consensual document representing the views of a range of European and American experts, in December 2000 (EU-US Biotechnology Consultative Forum 2000). The report was welcomed by both sides, and indeed

23 European Commission, "Biotechnology in Bilateral and Multilateral Fora," mimeo, Brussels, 25 July 2000.

24 The TEP Biotech Group, for example, is known to have met three times in 1999 and once in 2000, but the authors know of no subsequent meetings of this group. Interviews, US and EU Commission officials, Brussels, July 2002.

25 *Official Journal of the European Communities*, C 96 E, 27.3.2001, p. 247.

offered each side a partial endorsement of its own views.²⁶ Following this initial expression of support, however, the report itself was essentially shelved by both sides, which have scarcely ever made reference to it in the subsequent years of conflict over the issue.

Along similar lines, finally, both the United States and the European Union fostered the development of official "civil-society dialogues" among business, consumers, environmentalists, and labour unions. Although the latter two groups met only a few times and are currently defunct, the Transatlantic Business Dialogue (TABD) and the Transatlantic Consumer Dialogue (TACD) have both met regularly since the mid-1990s and both have taken clear stances on the regulation of biotechnology. The TABD established an Agri-Food Biotechnology Group to conduct studies and prepare recommendations, and throughout the 1990s the TABD generally adopted a position aligned with that of the United States, calling for compatible standards between the US and the EU to promote transatlantic trade in GMOs and arguing that mandatory labelling of GMOs "unfairly discriminates among identical or like products" (TABD 2002). Faced with increasing public opposition to GMOs, however, as well as organizational difficulties among the CEOs who constituted its membership, the TABD has since taken a much lower profile on the issue of biotechnology regulation, with no mention of GMOs or biotechnology in its 2004 annual report (TABD 2004; Corporate Europe Observatory 2001). By contrast, the Transatlantic Consumer Dialogue has been consistently active on the issue of biotechnology regulation since the 1990s, with US consumer organizations joining their European colleagues in calling for mandatory pre-market approval of all GMOs as well as mandatory labelling and traceability provisions. Clearly closer to the EU position than the US position on biotech regulation, the TACD has also called on several occasions for the US to abandon its WTO complaint against the EU, warning of "a 'pyrrhic victory' by the US given the reaction of European consumers" (TACD 2004; see also TACD 2003). In recent years, however, TACD representatives have grown increasingly frustrated at their apparently limited influence upon and access to US leaders in particular: hence the main importance of the TACD thus far appears to be its impact on US

26 The report, for instance, endorsed the precautionary principle as a core element of biotech regulation, and also called for mandatory pre-approval of all GMOs, including those generally recognized as safe—both core elements of the EU regulatory procedure; see European Commission, "Commentary on the Report by the Commission Services," http://europa.eu.int/comm/external_relations/us/biotech/ec_commentary.htm, accessed on 11 June 2004. By contrast, the US State Department highlighted the report's emphasis on the potentially beneficial effects of biotechnology as well as its discussion of openness and transparency in the regulatory process—"many of [which] are already a part of the US regulatory system." See US Department of State, "Fact Sheet: Report of US-EU Biotechnology Consultative Forum," 19 December 2000, http://www.usembassy.it/file2000_12/alia/a0121901.htm, accessed on 11 June 2004.

consumer groups, which have been regularly exposed to the more critical views of their European counterparts (see section V-B below).

IV. Multilateral Forums: Transatlantic Contestation in Three International Regimes

By the late 1990s, the anti-GMO movement was rapidly moving beyond the European Union, potentially affecting not only US exports to Europe, but also around the world. Japan and Korea, two WTO members traditionally raising barriers to US agricultural exports, announced that they would tighten approval procedures for genetically modified varieties and require mandatory labelling of genetically modified seeds and foods (Saegusa 1999; Aritake 1999; Pruzin 2000). In the Japanese market, prices for GMO-free varieties were surging, companies and department chains were advertising GMO-free foods, and a new GMO-inspection industry was developing (Aritake 1999). Even Australia and New Zealand, large agricultural exporters, announced in 1999 that they would require labelling of all GMO-derived foods (University of Illinois 1999: 60). The majority of developing countries, generally concerned over the expansion of patent and other rights over seeds and plant varieties, supported a move toward a restrictive new treaty on genetically modified foods, criticizing the monopoly rights that large US and European firms hold over new seed technologies. Some, such as Thailand, also welcomed new price premiums available for their GMO-free varieties. The Brazilian state of Rio Grande de Sul even declared itself a GMO-free zone in the hope of assuring and attracting foreign buyers of its crops (Shea 2000), and in 2002 the African countries of Zambia, Zimbabwe and Mozambique rejected food aid from the United States that was produced using biotechnology. The United States responded forcefully to these developments. In a June, 2003, speech to the Biotechnology Industrial Organization (BIO), President George Bush denounced EU limits on the imports of GMOs based on "unfounded, unscientific fears... For the sake of a continent threatened by famine," Bush continued, "I urge the European governments to end their opposition to biotechnology."²⁷

In this context, neither the US nor the EU limited its attention to bilateral discussions. Rather, both actors sought systematically to "export" their respective regulatory approaches and philosophies within each of the three relevant multilateral regimes, namely the World Trade Organization and its related Agreement on Sanitary and Phytosanitary Measures (SPS Agreement), dealing with

27 United States Mission to the European Union, "Bush: Biotech Key to Fighting Global Hunger, Terrorism," 23 June 2003, <http://www.useu.be/Categories/Biotech/June2303BushBiotech/html>, accessed on 11 June 2004. The African situation was also invoked in the US's WTO complaint; see e.g. "US Argues EC GMO Moratorium Hurts Developing Countries," *Bridges Weekly World Trade Digest*, Vol. 8, No. 15, 28 April 2004.

trade-related aspects of GM foods and crops; the Biosafety Protocol signed at Cartagena in 2000, dealing with the environmental implications of GMOs; and the Codex Alimentarius Commission, dealing with food-safety issues. Consistent with the preferences and views discussed above, the United States has sought within each of these forums to export its relatively science-based approach to biotechnology regulation, while the European Union has sought to secure international recognition for its approach and in particular for its interpretation of the precautionary principle. The result thus far in each of the three regimes has been an untidy compromise between the two positions, with no clear victory for either side and little or no evidence of convergence of views on the central issues.

A. The WTO and the SPS Agreement

Differences among national risk regulations can create significant non-tariff barriers to trade in agricultural and food products. The problem of non-tariff barriers caused by differences in national risk regulation was addressed explicitly in the 1994 WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), which was negotiated as part of the Uruguay Round of Trade Agreements that created the WTO and its binding dispute settlement system. The SPS Agreement does not establish international standards for biotechnology or other food-safety questions (a role left to the Codex Alimentarius Commission; see below), nor does it automatically pre-empt the adoption of non-discriminatory national food safety regulations that might inhibit international trade. However, the Agreement does incorporate and promote the adoption of international standards and establishes trade rules that limit the ability of states to adopt trade-restrictive regulations without scientific support. The SPS Agreement places the onus on a state that would restrict trade through national regulations to demonstrate that such regulations are based on scientific risk assessments, and are not otherwise disguised restrictions on trade. The terms of the SPS Agreement, are, moreover, binding under international trade law, and enforceable before WTO dispute settlement panels and the WTO Appellate Body.²⁸

Not surprisingly, given the importance of transatlantic trade in foodstuffs, the political pressure from EU farmers to protect the EU market and from US farmers to open it, and the differences in the US and EU regulatory systems, the first and most important food safety dispute under the SPS Agreement was brought by the United States against the European Union, over the issue of hormone-treated beef. The dispute began in 1989, when the European Union (acting under the terms of a 1988 directive) instituted a ban on the use of synthetic growth hormones in beef cattle, and prohibited the import of animals, or meat from animals, that had been treated with such hormones. Although the EU Directive had been adopted primarily

28 For good discussions, see Victor, 2000: 865-937; and Howse, 2000: 2329.

on the grounds of European consumer concerns about the safety of hormone-treated beef, the ban had an immediate and dramatic impact on beef producers in the United States, where some ninety percent of all beef cattle are treated with synthetic growth hormones, and where FDA studies have consistently shown that the growth hormones in question are safe for human consumption.

In 1995, after the entry into force of the SPS Agreement and the WTO's Dispute Settlement Understanding, the US initiated legal action against the EU, alleging that the EU ban was inconsistent with the terms of the SPS Agreement because it was not based on scientific evidence, a risk assessment, or agreed international standards, and it arbitrarily differentiated between products. The EU, by contrast, argued that the SPS Agreement acknowledges the right of states to determine the appropriate level of health protection for their consumers, and that the ban was justified under the precautionary principle (Seilheimer 1998: 544-45). A WTO dispute settlement panel was established in May 1996, and issued its report in favour of the US in August 1997. The EU appealed the panel's decision, and the WTO Appellate Body issued a second report in January 1998, once again in favour of the United States. The WTO panel and appellate decisions were both complex, involving hundreds of pages of scientific testimony and legal reasoning. While the Appellate Body overrode the panel's assessment on several issues, it agreed that the EU had failed to base its beef-hormone ban on a scientific risk assessment, undermining the EU's claims that the ban was adopted to protect human health (see Seilheimer 1998: 546-59). In response to the EU's invocation of the precautionary principle, both the original panel and the Appellate Body found that the precautionary principle could not override the express provisions of the SPS Agreement, in particular the requirement of a risk assessment (Article 5.1 of the SPS Agreement).²⁹ In accordance with the Appellate Body's findings, the Dispute Settlement Body ruled in February 1998 that the EU ban was inconsistent with the terms of the SPS Agreement, and instructed the EU to bring its regulations into compliance by no later than 13 May 1999.

Facing continuing pressure from its own consumers, however, and hopeful of producing additional scientific findings that might justify the ban, the EU failed to act, and the US retaliated on 17 May 1999, applying tariffs in the amount of \$116.8 million targeted against specific EU products such as *foie gras*, Roquefort cheese and Dijon mustard. These US tariffs in turn sparked a wave of protests among French and other European farmers, including an attack in August 1999 by a group of French farmers on a McDonald's restaurant, selected as the symbol of the threat

29 Article 5.1 provides, "Members shall ensure that their sanitary or phytosanitary measures are based on an assessment, as appropriate to the circumstances, of the risks to human, animal, plant life or health, taking into account risk assessment techniques developed by the relevant international organizations."

of both American cuisine and globalization to French traditions.³⁰ Although the leader of the farmer's group, Jose Bové, was jailed for his part in the attack, he was later hailed as a hero in the French press for his opposition to American efforts to force upon Europeans foods that were widely seen as both unwanted and unsafe. As of September 2004, both the EU's beef hormone ban and the US punitive tariffs remained in place, in spite of the expressed desire of both sides to reach a negotiated settlement (Mavroidis 2003).

The transatlantic dispute over the EU's moratorium on the approval of new GM varieties (and its subsequent decision that all GM products be subject to pre-approval traceability and labelling requirements) is analytically similar to the dispute over beef hormones. EU trade-restrictive regulations on GMOs were once again adopted without conducting a scientific risk assessment. US governmental authorities again sided with US producers and repeatedly protested to the EU bilaterally and before relevant WTO committees. Until 2003, however, the Clinton and Bush Administrations refrained from taking legal action before the WTO, fearing that such a case could potentially prompt a European consumer backlash against GMOs. In the interim, both the US and the EU took their regulatory dispute to other international forums, each seeking to alter the terms of the international debate in its own favour.

B. The Cartagena Biosafety Protocol and the Precautionary Principle

The first—and from the perspective of the EU, the most promising—of these forums was the 1992 Convention on Biodiversity, one of a series of framework agreements adopted at the 1992 Conference on Environment and Development at Rio de Janeiro, Brazil. By contrast with the case of hormone-treated beef, where no other international treaty existed to support EU claims regarding its right to restrict imports of hormone-treated foods, the Convention on Biodiversity offered a forum within which the EU could press for an international environmental agreement supporting its precautionary approach to biotech regulation. In the GMO case, moreover, the vast majority of parties to the Convention supported a protocol to the Convention dealing with the transfer of living genetically modified organisms (LMOs). A more reticent United States and a small number of grain exporting countries were first able to block the signature of a protocol in February 1999 in Cartagena, Columbia. However, all countries eventually compromised and the Protocol was signed in Montreal on January 29, 2000.

The three central issues that divided the US from the EU and most of the world were: (i) the application of the precautionary principle to decisions to ban imports and require labelling; (ii) whether the Protocol should cover bulk commodities

30 "McDonald's encapsulates it all," in the words of one commentator. "It's economic horror and gastronomic horror in the same bun." Guillaume Parmentier, quoted in Henley 1999.

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intended for consumption (e.g. crops) or be limited to organisms intended for direct introduction into the environment (e.g. seeds); and (iii) the relation of the Protocol to WTO rules. The parties compromised on all three issues, though the greatest compromises were arguably made by the United States in that the Protocol curtails some US rights under the WTO's Sanitary and Phytosanitary Agreement. First, the two sides compromised over the issue of the integration of the precautionary principle into the Protocol. On the one hand, Article 15 of the Protocol provides that countries will undertake "risk assessments... in a scientifically sound manner." On the other hand, Article 10 of the Protocol expressly incorporates the precautionary principle, providing that a country may reject the importation of "a living modified organism for intentional introduction into the environment" where there is "lack of scientific certainty regarding the extent of the potential adverse effects... on biological diversity in the Party of import, taking also into account risks to human health." A similar provision applies to a country's rejection of bulk genetically modified commodities (such as soybeans, wheat, corn and cotton) for food, feed or processing (Article 11).³¹

At first glance, the US largely prevailed in having the Protocol's mandatory pre-shipment notification and consent provisions limited to genetically modified organisms intended for release into the natural environment (e.g. planting), so that these provisions do not apply to bulk crops intended for food processing and mass consumption (Article 5). Rather, as for bulk shipments of crops, the US is only obligated to notify a Biosafety Clearing-House once it approves a GMO for the US market. However, the Protocol leaves it to each country to decide whether to permit the importation of such products and provides that they may apply the precautionary principle in making this decision (see above). In addition, such shipments must be clearly labelled that they "may contain" living modified organisms (Article 18).

As for the relation of the Protocol to WTO rules, the US failed to obtain a clear reservation of its WTO rights. Rather, references to other "international agreements" are only made in the Protocol's preamble, and these references are contradictory. The preamble provides that "this Protocol shall not be interpreted as implying a change in the rights and obligations of a Party under any existing international agreements." The next phrase, however, states that "the above recital is not intended to subordinate this Protocol to other international agreements." As an EU representative stated, the two clauses effectively "cancel each other out," leaving the legal relationship between the two regimes unclear and allowing both sides to claim a partial victory (Inside US Trade 2000). The EU, therefore, could point to the Biosafety Protocol as evidence of an international consensus (involving

31 While US government authorities may maintain that this reference to "human health" is only made in the context of a treaty on biodiversity that does not address food safety *per se*, clearly the US would have preferred that no such broad statement were included.

over 130 countries) regarding the application of the precautionary principle to the regulation of biotechnology. The US, by contrast, could plausibly claim that nothing in the Biosafety Protocol compromised US rights under the SPS Agreement, which it would invoke in its 2003 challenge to the EU's biotech regime.

The Protocol itself took effect on 11 September 2003, and at this writing has been ratified by 100 parties, including the European Community.³² The United States, by contrast, is not a party to the Convention on Biological Diversity and hence has not signed or ratified the Cartagena Protocol; nevertheless, the US participated as an observer in the first conference of the parties in February 2004, and has indicated that "as a practical matter, firms in non-Party countries wishing to export to Parties will need to abide by domestic regulations put in place in the importing Parties for compliance with the Protocol."³³

C. The Codex Alimentarius Commission

The Codex Alimentarius Commission (Codex) is an intergovernmental body established in 1962 by the UN Food and Agriculture Organization (FAO) and the World Health Organization (WHO) to promote international trade in food through the adoption of international food-safety standards. Throughout the post-war era, the United States and the European Union countries (represented individually by the EU's member governments) have cooperated within Codex on the establishment of international food-safety standards. The WTO's SPS Agreement, however, substantially increased the Codex Commission's notoriety, providing that national food safety standards based on international (Codex) standards are presumed to comply with WTO law. For this reason, both the United States and European countries have placed increasing importance on the negotiation of new regulatory principles and standards within Codex, since these principles and standards may be invoked (and already have been invoked) in the decisions of WTO panels and of the Appellate Body. This enhanced importance of Codex also led to a major campaign by the EU to gain full membership in Codex, culminating in the formal accession of the EU in November 2003.³⁴ The Commission now speaks and votes on behalf of the EU "where an agenda item deals with matters of exclusive Community competence."³⁵ In practice, this means that the Commission will almost always represent the member states in Codex on biotech matters, since annex II of the

32 See the Protocol website at: <http://www.biodiv.org/biosafety/>, accessed on 11 June 2004.

33 United States Department of State, "Fact Sheet: Cartagena Protocol on Biosafety," <http://www.state.gov/g/ocs/rls/fs/2004/28621.htm>, accessed on 11 June 2004.

34 See Council Decision of Nov. 17, 2003 on the accession of the European Community to the Codex Alimentarius Commission.

35 *Id.*, Annex III, Agreement between the Council and the Commission regarding preparation for Codex Alimentarius Meetings and statements and exercise of voting rights.

Council Decision provides: "As a general rule, the European Community has exclusive competence for agenda items dealing with harmonization of standards on certain agricultural products, foodstuffs [...], including labelling, methods of analysis and sampling, as well as codes and guidelines."³⁶

The subject of biotechnology regulation first came before Codex during the 1990s. A dedicated Working Group on Biotechnology was established in 1999, negotiating and adopted a number of international guidelines on the regulation of biotechnology before being disbanded in 2003. The Codex Commission has therefore been the forum for strenuous negotiations between the governments of the United States and the European Union, each of which has once again put forward distinctive and sharply opposed proposals for international standards on issues such as the use of the precautionary principle, the use of "other legitimate factors" besides science in risk management, and the use of labelling and traceability requirements for bioengineered foods.³⁷

First, with regard to the application of the precautionary principle, the Working Group was charged with devising guidelines on risk regulation under uncertainty, with the EU and the US each advocating their traditional approaches to the question Poli (2003: 133-137). The EU sought an expansive definition of the precautionary principle as applying to both risk assessment and risk management. The US delegation, in contrast, noted pointedly that, "a precautionary approach was already built into risk assessment; this concept should not be used by risk managers to overrule risk assessment" (quoted in Poli 2003: 134). After nearly four years of debate, the Codex Commission agreed to a compromise text that acknowledged precaution "as an inherent element of risk analysis," while offering little clarification about its use at either the national or international levels.

The US and the EU clashed in predictable fashion on a second transversal issue, namely the guidelines for the invocation of "other legitimate factors" (dubbed OLFs) besides science that could be invoked by the Codex Commission in establishing international standards. Following domestic EU law and practice (see below), EU members argued that the Codex should consider a range of OLFs, such as consumer concerns and animal welfare, while the United States argued that "giving consideration to [...] these factors could open a Pandora's box," and therefore sought to restrict Codex decision-making to scientific considerations. Here again,

36 Id. Annex II, par. 1. Single Declaration by the European Community on the exercise of competence according to Rule VI of the Rules of Procedure of the Codex Alimentarius Commission.

37 This section benefits from the excellent overviews in Poli 2003 & 2004. For other discussions of biotechnology in the Codex, see e.g. the articles in Kalaitzandonakes and Phillips, eds. (2000) as well as the reports and recommendations of the Codex ad hoc Intergovernmental Task Force on Foods Derived from Biotechnology, accessible on the FAO web page at http://www.fao.org/es/ESN/food/risk_biotech_taskforce_en.stm.

the members eventually reached agreement on an amendment to the Codex Manual of Procedure allowing the invocation of OLFs in risk management decisions, but it provided no listing of these other legitimate factors, noting instead that "only those other factors that can be accepted on a world-wide basis, or on a regional basis in the case of regional standards and related texts, should be taken into account in the framework of Codex." The statement went on to note that consideration of other relevant factors should not affect the scientific basis of risk analysis or create "unjustified barriers to trade" (quoted in Poli 2003: 140). In effect, the compromise reached within the committee allowed for the invocation of unspecified OLFs in Codex decision-making, but proceeded to constrain that invocation with a series of more or less vaguely stated restrictions.

Finally, the US and EU engaged in contentious negotiations dealing with the regulation of GM foods where characterized by the now-familiar US/EU divide over the issues of labelling and traceability of GM foods. Although the Codex members were eventually able to agree in July 2003 to new "Principles and Guidelines on Foods Derived from Biotechnology," the document provides no guidance regarding the labelling of GM foods because US and EU positions proved impossible to reconcile.³⁸ With regard to traceability, the Principles acknowledge the use of "tracing of products" as a risk-management tool, representing a partial victory for the European countries, but goes on to note in a footnote that they "should be consistent with the provisions of the SPS and TBT Agreements."³⁹

The results of these negotiations, Poli (2003: 146-47) points out, have thus far proven disappointing. "After lengthy discussions," she argues, "these conflicts led to poor compromises, which do not have practical impact on the activity of the Codex Commission." Like the paragraphs of the Cartagena Protocol dealing with the relation between Cartagena and WTO law, much of the Codex texts simply paper over rather than settle the differences among the parties, potentially delegating clarification of these issues, if at all, to the WTO dispute settlement system.

38 The principles were formally adopted in July 2003. See Codex Alimentarius Commission. Report of the Twenty-sixth Session (Rome, 30 June-7 July 2003), par. 52, document available at ftp://ftp.fao.org/esn/food/princ_gmfoods_en.pdf. See also Anne Mackenzie, "The Process of Developing Labeling Standards for GM Foods in the Codex Alimentarius," 3 *AgBioForum* 203 (2000); and Vogel 2001, at 11.

39 See Codex ad hoc Intergovernmental Task Force on Foods Derived from Biotechnology. *Codex Principles and Guidelines on Foods Derived from Biotechnology*, available at ftp://ftp.fao.org/esn/food/princ_gmfoods_en.pdf, at par. 21, accessed on 9 June 2004.

V. US and EU Policies Since 2000: Convergence?

During the course of the 1990s and the early years of the following decade, in sum, both the US and the EU were involved in both bilateral efforts to coordinate their respective policies through transatlantic dialogue, while at the same time actively exporting their respective views in multilateral regimes such as Codex and the Biosafety Protocol. During this period, some observers hoped that the US and EU regulatory systems might converge as a result of joint deliberation, reducing the substantial disparity among the two systems and thereby mitigating the substantial trade tensions and resulting political conflicts between them. Many American observers hoped that the EU might move towards a more "science-based" and less "politicized" system of regulation, which would, in turn, facilitate the resumption of approvals for new GM varieties. Many European observers, by contrast, hoped that the European Union's stricter standards would prompt a process of "trading up" in the United States, which might become more precautionary in its own regulations (Young 2003). Indeed, recent years have witnessed the overhaul of EU regulations and the resumption of approvals within the Union, as well as a significant debate among US producers, consumers, and regulators about the adequacy of the US regulatory framework. Nevertheless, a careful examination of recent developments reveals, at best, a modest convergence between the US and the EU, which retain distinctive systems in terms of regulatory philosophies, procedures, and policy outcomes.

A. *Review of European Regulatory Developments*

By the late 1990s, the European Commission, facing competing pressures from the United States and domestic European opinion, looked for a way to resume approvals of genetically modified varieties, free up commerce in the internal market, assuage member states and their constituents that adequate controls were in place, implement an EU-wide labelling regime, and restrict member state opt-out rights under "safeguard" provisions. Toward this end, in January 2000 the Commission issued a White Paper on Food Safety in which it proposed that the EU overhaul its food safety system and establish a new centralized EU agency, which was eventually named the European Food Safety Authority (EFSA), to assist with risk regulation.⁴⁰ The White Paper set forth the EU's general approach to risk regulation

40 In 2002, the Council and European Parliament adopted EC Regulation 178/2002 pursuant to which the new agency, named the European Food Safety Authority, was created. While member states debated and lobbied over its ultimate location, the EFSA was temporarily housed in Brussels. The European Council finally determined in December 2003 that its headquarters would be established in Parma, Italy. See EFSA press release at http://www.efsa.eu.int/press_room/press_release/34_en.html. When fully operational, EFSA is expected to employ 250 people with a budget of 40 million euros, a tiny agency compared

in the food sector, dividing "risk assessment" from "risk management." Specialized scientific committees within the new food authority would conduct risk assessments, and the new authority would provide food safety information to consumers and operate a rapid alert system in conjunction with member state authorities to respond to food safety emergencies. Risk management, by contrast, would remain under the control of the EU's political bodies. In an annexed "action plan," the Commission set forth over eighty new food safety-related measures for adoption, including amendments to Directive 90/220 and the 1997 Novel Foods Regulation.

In February 2000, the Commission issued a Communication on the precautionary principle, indicative of EU authorities' more risk-averse approach in an increasingly politicized domain that was raising challenges to the legitimacy of EU law. The Commission declared that the "precautionary principle" would be applied whenever decision-makers identify "potentially negative effects resulting from a phenomenon, product or process" and "a scientific evaluation of the risk [...] makes it impossible to determine with sufficient certainty the risk in question [on account] of the insufficiency of the data, their inconclusiveness or imprecise nature." It stressed that "judging what is an 'acceptable' level of risk for society is an eminently *political* responsibility" (Commission's emphasis). The Commission nonetheless maintained that it hoped to provide some guidance regarding the application of the principle, which it acknowledged, was "giving rise to much debate and to mixed and sometimes contradictory views."⁴¹ Building on case law of the European Court of Justice, the Commission stated that where regulatory decisions are adopted in accordance with the principle, the resulting measures should meet a series of criteria, and, in particular, they should be proportionate, non-discriminatory, consistent, based on cost-benefit analyses where feasible, and subject to review and ongoing risk assessment.⁴² When the Council adopted a resolution on the precautionary principle at the Nice intergovernmental meeting in December 2000, its evocation granted policymakers greater flexibility. The resolution maintained that risk assessments may not always be possible on account of insufficient data, and that cost-benefit analyses should consider the "public

(contd.)

to the US Food and Drug Administration that employs over 9,000 people and has 2,100 scientists working for it (Buonanno 2003).

41 Commission (2000) at 15. The Commission observed that, although the precautionary principle is not defined in the EC Treaty (which only prescribes its use to protect the environment in article 174 of the Treaty), the European Court of Justice's case law had recognized the principle's application in other domains (Scott 2003, 228).

42 *Id.* The Commission observed that, although the precautionary principle is not defined in the EC Treaty (which only prescribes its use to protect the environment in article 174 of the Treaty), the European Court of Justice's case law had recognized the principle's application in other domains. See Scott 2003:228.

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acceptability” of risk management decisions.⁴³ The EU’s evocation of the precautionary principle, already too permissive in the views of US policymakers, had just become more so.

In response to challenges to the legitimacy of EU decision-making over GMOs from above and below, the Commission proposed new legislation in 1998 to govern the deliberate release of GMOs into the environment and the placing of GM food products on the market. Both the European Parliament and Council pressed the Commission for further regulatory controls. The majority of the European Parliament insisted on tighter restrictions regarding labelling requirements and thresholds pursuant to which products could contain traces of GMOs and still be sold in the EU. The member states were mixed in their views, with some appearing to do whatever possible to ensure that no GM crops would be grown in their territories (such as Austria and Luxembourg), and others being torn between the demands of GM opponents and those of the biotech sector (such as Germany and the United Kingdom). A “conciliation committee,” consisting of the members of the Council and fifteen representatives of the European Parliament, drafted the final text.⁴⁴

The resulting legislation, Directive 2001/18, was finally adopted in March 2001 by co-decision between the Council and the European Parliament.⁴⁵ The directive’s twin objectives were to protect the environment and human health when GMOs are released into the environment and placed on the market “as or in products,” in both cases to be applied “[i]n accordance with the precautionary principle.” Once more, the need to assuage those member states that desired stringent regulation of GMOs had led to a ratcheting up of EU regulatory requirements for GMOs so as to facilitate the free circulation of agricultural and food products in a single EU market (Young 2003). More specifically, under the directive’s environmental release requirements, member state and applicant obligations had been enhanced to include a more extensive environmental risk assessment, further information concerning the conditions of the release, and monitoring and remedial plans. The directive instructed the member states to adapt their laws to comply with its requirements by October 17, 2002, at which time Directive 90/220 would be repealed.

43 See Council Resolution on the Precautionary Principle, Annex III to the Presidency Conclusions, Nice European Council Meeting, 7-9 December 2000. See also Vogel 2001: 28-29.

44 For good accounts of the conciliation process, and the key issues separating the EP and Council delegations, see “Genetic Engineering: Key Issues in GMO Conciliation Become Clearer,” *European Report*, 1 November 2000; and “Biotechnology: Conciliation Talks Move Towards Agreement on GMOs,” *European Report*, 13 December 2000.

45 Directive 2001/18/EC of the European Parliament and of the Council, *Official Journal of the European Communities*, L 106 17 April 2001, pp. 1-38.

Although touted by the EP's rapporteur David Bowe as "the toughest laws on GMOs in the whole world,"⁴⁶ the adoption of Directive 2001/18 did not satisfy a core of a core of member states (in particular Austria, Denmark, France, Greece, Italy, and Luxembourg), which continued to insist on the moratorium's continuation and on the need to impose national safeguard bans in the absence of still more stringent EU regulations.⁴⁷ Unable to obtain the regulatory committee's approval of a legal challenge against these bans, the Commission worked toward passage of yet further EU legislation governing the authorization, labelling, and traceability of GM products. For this reason, only the directive's provisions governing the release of GMOs into the environment were fully implemented,⁴⁸ while its provisions governing the marketing of GMOs used for commercial crops were largely replaced within a mere eighteen months by two new EU regulations regarding the labelling and traceability of GM foods and their use in food and feed, respectively. Proposed by the Commission in 2001, these new regulations were finally adopted in September 2003, once again after drawn-out bargaining among the Commission, Council, and European Parliament.⁴⁹ Both legislative instruments took the form of regulations, and not directives, placing authority predominantly in the hands of Community institutions. Regulation 1829/2003, regarding the authorization of GMOs in food and feed, replaced the provisions of Directive 2001/18 governing the authorization for marketing of GMOs as or in products,⁵⁰ and the labelling

46 Quoted in Blake Evans-Pritchard, "Vote on GMO Legislation Today," *euobserver.com*, 14 February 2001, accessed on 6 June 2003.

47 In a joint statement, France, Italy, Austria, Denmark, Greece and Luxembourg "reaffirm[ed] their intention [...] of ensuring that the new authorizations for cultivating and marketing GMOs are suspended pending the adoption" of new provisions on traceability, labeling, and environmental liability. Quoted in Michael Mann, "Six EU States Refuse to Lift Block on New Modified Crops," *Financial Times*, 16 February 2001, p. 8.

48 Part B of the directive covers the "deliberate release of GMOs for any other purpose than for placing on the market" that go beyond the "contained use" of GMOs (i.e. it addresses pilot testing of GMOs in pilot plots). Directive 90/219, as amended, continues to govern the contained use of GMOs. Council Directive 98/81/EC of 26 Oct. 1998 amended Directive 90/219.

49 The Commission initiated its original proposals in 2001. See Commission of the European Communities, "Proposal for a Regulation of the European Parliament and the Council on Genetically Modified Food and Feed," COM(2001)425 final of 25 July 2001; and Commission of the European Communities, "Proposal for a Regulation of the European Parliament and the Council Concerning Traceability and Labeling of Genetically Modified Organisms and Traceability of Food and Feed Products Produced from Genetically Modified Organisms and Amending Directive 2001/18/EC," COM(2001)182 final of 25 July 2001. For the Commission's amended proposal, see COM(2002)559 final.

50 Article 5.5 of Regulation 1829/2003 provides that articles 13-24, constituting Part C of Directive 2001/18, "shall not apply," but rather be replaced by the new, more centralized authorization procedures. Note that, in order to be marketed in the Union, GM seeds must also meet the standards requirements for all seed varieties to be placed in the Union's "common

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provisions of the Novel Foods Regulation. Regulation 1830/2003, in turn, created new rules on the traceability of GM products throughout the production and distribution process. Both regulations became effective on April 18, 2004. The revised EU regulatory scheme is summarized in Table 2.

Table 2

EU Legislation Governing GMOs and GM Products as of May 2004

Step-by-step Activities in the Production Process	Applicable EU Legislation
GMO research in laboratories	Contained Use Directive 90/219
GMO experimental releases (trials)	Directive 2001/18
GMO environmental releases for crops	Regulation 1829/2003 and Directive 98/95/EC (common seed catalogue)
Authorization of marketing of GM seeds (for environmental releases for crops)	Regulation 1829/2003 and Directive 98/95/EC
Authorization of marketing of GM food and feed	Regulation 1829/2003
Labelling of GM seed, food and feed	Regulation 1829/2003
Traceability and labelling of GM products	Regulation 1830/2003

Importantly, Regulation 1829/2003 created a more centralized authorization procedure to regulate the placing of GM food and feed on the EU market. With a more centralized procedure, the Commission hopes to better manage countervailing member-state and US challenges to the EU's regulatory regime. The application process still begins when an operator submits an application file to the competent authority from one of the member states. That member state authority, however, now immediately provides the file to the new European Food Safety Authority, which, in turn, provides a copy to the other member states and the Commission, and makes a summary of the file publicly available. EFSA is to issue its opinion, based on risk assessments, within six months from its receipt of the file, subject to extensions if further information is needed. EFSA submits its opinion to the Commission, the member states, and the applicant, and, after the deletion of any confidential information, makes it publicly available. The Commission is then to

(contd.)

catalogue of agricultural plant species." See e.g. Council directive 98/95/EC of 14 December 1998 (concerning requirements for such listings).

issue a draft decision, which may vary from EFSA's opinion. The Commission's draft decision is again provided to the regulatory committee consisting of member state representatives. The committee is to deliver its opinion on the Commission's proposed decision by a qualified majority. If the committee delivers no opinion or a negative opinion, the Commission must submit its proposal to the Council. If the Council does not adopt (or indicate its opposition to) the Commission's proposal (but this time by a qualified majority vote, as opposed to a unanimous one), then the proposed decision "shall be adopted by the Commission." Any authorization of a GM variety is now limited to a term of ten years, although it is subject to renewal. (For a brief summary of current authorization procedures, see Table 3.)

Although the procedural scheme at the EU level is somewhat similar to that provided under Directives 90/220 and 2001/18, it became more centralized in two primary respects. First, EFSA, a centralized EU agency, oversees the application file and works in conjunction with member state competent authorities and a Community reference laboratory to conduct risk assessments and product evaluations. Second, the regulation restricts the grounds on which member states may ban GMOs unilaterally as a "safeguard" measure. A member state may adopt "interim protective measures [...] where it is evident that products authorized [...] are likely to constitute a serious risk to human health, animal health or the environment," provided that it first informs the Commission of the "emergency" situation and the Commission does not act. The Commission's original proposal provided for no member state safeguard powers, but the Parliament and Council succeeded in including this clause.⁵¹

The regulation also broadened the scope of product coverage in two ways. First, the regulation's authorization and labelling requirements covered GM animal feed for the first time, in addition to food for human consumption. Second, the regulation covered food and feed that do not contain or consist of GMOs, but nonetheless are "derived, in whole or in part, from GMOs" or contain ingredients that are "derived, in whole or in part, from GMOs." The regulation likewise reduced the threshold for permitted traces of genetically modified ingredients, provided their presence is "adventitious" (although it did not go as far as the Parliament preferred), and it provided that the Commission may further lower these thresholds over time.

One of the most controversial elements of the new regulation was the establishment of a set of thresholds for permitted traces of genetically modified ingredients, provided their presence is "adventitious." Recognizing that it is practically impossible to ensure that any crop is entirely GM free, the Commission initially proposed a threshold of 1% GM material, below which any crop would not have to be labelled as containing GM foods. The Commission's proposed threshold

51 See COM (2001) 425 (GM food and feed).

Table 3

Authorization Process for GM Food and Feed under Regulation 1829/2003

1. An operator submits an application to the competent authority from one of the member states.
2. The member state provides the file to the new European Food Safety Authority (EFSA).
3. The EFSA provides a copy to the other member states and the Commission, and makes a summary of the file publicly available, and makes a summary of the file publicly available.
4. Within six months, the EFSA its opinion, based on risk assessments submits its opinion to the Commission, the member states, and the applicant, and, after the deletion of any confidential information, makes it publicly available.
5. The Commission is then to issue a draft decision, which may vary from EFSA's opinion, based on the regulatory committee consisting of member state representatives.
6. The committee is to deliver its opinion on the Commission's proposed decision by a qualified majority. If the committee delivers no opinion or a negative opinion, the Commission must submit its proposal to the Council. If the Council does not adopt (or indicate its opposition to) the Commission's proposal (but this time by a qualified majority vote, as opposed to a unanimous one), then the proposed decision "shall be adopted by the Commission"

was contested, however, by environmental groups such as Greenpeace and the European Consumers Organization (BEUC), by the European Parliament, and by several member governments in the Council, all of which called for lower thresholds. European biotech companies and the United States government, by contrast, criticized the one percent threshold as unrealistic, unnecessarily costly and scientifically unjustified. These divisions were mirrored in the Council, where the United Kingdom favoured the Commission's proposed 1% threshold, while Austria at the other extreme favoured thresholds as low as 0.1%.⁵² The final regulation represents a compromise among these two positions, and establishes two distinct

52 "Biotechnology: Member States Agree on GM-Labeling of Food." *European Report*, 4 December 2002. For other good accounts of the debate over thresholds in Regulation 1829/2003, see e.g. "Biotechnology: MEPs Draw Inspiration from Hearing on Labeling and Tracing GM Food." *European Report*, 1 May 2002; Bettina Berg, "GMO Proposals Adopted in European Parliament." *euobserver.com*, 3 July 2002.

thresholds. First, it provides that food products will not violate its labelling requirements if they contain material consisting of or produced from EU-approved GMOs "in a proportion no higher than 0.9% of the food ingredients considered individually [...] provided that this presence is adventitious or technically unavoidable." Second, however, the regulation establishes a second and stricter threshold of 0.5% for GMOs not yet approved for environmental release in the EU, and establishes a three-year window after which no residues of such non-approved GMOs will be allowed in food and feed products.

Regulation 1830/2003, finally, complemented the new authorization and labelling rules with a more centralized framework for tracing genetically modified products, as Directive 2001/18 had left this responsibility to the member states. The new regulation required the Commission to establish a system of unique identifiers for each genetically modified organism in order "to trace GMOs and products produced from GMOs at all stages of their placing on the market through the production and distribution chain." More specifically, the regulation requires producers to collect and retain for five years data regarding the GM content of foods and crops one step backward and one step forward in the distribution chain. These strict traceability requirements have been bitterly criticized by many US producers (whose commodity system does not require and is not designed for tracing GMOs through the distribution chain), as well as by some European producers. The Commission, however, has justified it as vital to the EU labelling system as well as for any future recalls of GM foods or crops.⁵³

The Commission and biotech companies tried to step up enforcement against member state non-compliance in 2003. In April of that year, the Commission issued a "letter of formal notice" to twelve member states that had failed to implement Directive 2001/18, as required (Kirwin 2003). It initiated a lawsuit against eleven of them in July pursuant to Article 226 of the Treaty. When Austria proposed to make the region of Upper Austria a GM-free zone in March 2003, the Commission (following an opinion from EFSA)⁵⁴ ruled that Austria's general ban would be illegal since GMO restrictions should be based on attributes of specific GMOs. Concurrently, three biotechnology companies (Monsanto, Syngenta, and Pioneer) challenged Italy's ban of food products containing authorized GM maize before the Italian courts. An Italian lower court referred the matter to the European Court of Justice for an interpretation of EU law pursuant to Article 234 of the Treaty. In September 2003, the European Court of Justice ruled that Italy must conduct "a risk

53 See e.g. the comments of Tony Van Der Haegen, minister counselor at the EU Delegation in Washington, D.C., who referred to the US grain handling system as "very efficient, but [...] totally incompatible with the traceability system." Quoted in "US Grain System Said Incompatible with EU Rules," *Reuters*, 13 July 2001.

54 See *The EFSA Journal* 2003 (opinion of 4 July 2003).

assessment which is complete as possible [...] from which it is apparent that, in light of the precautionary principle, the implementation of such measure is necessary in order to ensure that novel foods do not present a danger," which Italy had so far failed to show.⁵⁵

Finally, the EU resumed approvals of new GM varieties in May 2004. By early 2004, the Commission had received twenty-two notifications for approvals of genetically modified varieties—eleven involving import processing only, and eleven for cultivation (Commission 2004b)—and with the completion of the proposed regulatory framework, it moved to resume approvals of new GM varieties. In November 2003, therefore, the Commission proposed to approve the importation of a variety of GM maize (Bt-11 sweet corn), for which EFSA had delivered a favourable opinion. It was the first time that the Commission had initiated a GM approval since 1998. The regulatory committee, however, again refused to approve the Commission's proposal so that the matter was referred to the Council, which was given until the end of April to act.⁵⁶ On 26 April, a divided Agriculture Council failed to reach agreement on the Commission's proposal.⁵⁷ In the absence of a decision by the Council, the Commission was free to adopt the proposal—the first new approval of a GM variety in nearly six years.

Despite this apparent breakthrough, US officials noted that the Commission's decision—greeted by a chorus of condemnation among European environmentalists and consumer groups—was taken over the objections of a bloc of implacably hostile member governments, with no guarantee that additional approvals were to follow or that EU risk managers would continue to be guided by the scientific risk

55 The matter then returned to the Italian courts to apply the ruling based on Italy's presentation of any studies supporting its restrictions. See Judgment of the Court, Case C-236/01 (reference for a preliminary ruling from the Tribunale amministrativo regionale del Lazio): *Monsanto Agricoltura Italia SpA and Others v Presidenza del Consiglio dei Ministri and Others* (Sept. 9, 2003). Similarly, the Court of Justice ruled in March 2000 that France could not ban the sale of GM crops that had been approved at the EU level without producing new information regarding health and environmental risks. The case was referred to the Court of Justice by a French court following a challenge by Greenpeace of France's initial approval of a GM maize variety. See Judgment of the Court, Case C-6/99 (reference for a preliminary ruling from the Conseil d'État): *Association Greenpeace France and Others v French State, Ministère de l'Agriculture et de la Pêche and Others*, In the presence of *Novartis Seeds SA and another* (March 21, 2000).

56 Austria, Denmark, France, Greece, and Luxembourg voted against the proposal, while Germany, Belgium, and Italy abstained. See Bridges on-line report 2004.

57 Six states (Ireland, Italy, the Netherlands, Finland, Sweden, and the UK) voted in favor of the Commission proposal, six others (Denmark, Greece, France, Luxembourg, Austria, and Portugal) voted against, and three states (Belgium, Germany, and Spain) abstained. Commission 2004c: 4.

assessments carried out by the EFSA.⁵⁸ Moreover, the Commission's approval applied only to importation and not cultivation, and was subject to the full range of EU regulations regarding traceability and labelling, with all their attendant costs. Under the circumstances, Syngenta, the crop's manufacturer, indicated that it had no immediate intention of marketing Bt-11 sweet corn in Europe (Meller and Pollack 2004; Pollack 2004; European Report 2004).

Subsequent approval procedures appeared to support this cautious interpretation of the "end" of the moratorium. One month following the approval of Bt-11 sweet maize, a regulatory committee of member-state representatives from the now-enlarged EU failed to agree on the Commission's proposed approval of a genetically modified rapeseed (or canola). Significantly, six of the ten new member states (Cyprus, Estonia, Hungary, Malta, Lithuania, and Poland) joined six existing members (Austria, Denmark, Greece, Italy, Luxembourg, and the UK) in voting against the approval, which was then scheduled for decision by the Council of Ministers.⁵⁹ A similar pattern emerged later the same month when the Environment Council met to consider the Commission's recommendation to approve another Monsanto variety, the NK603 genetically modified corn. Here again, the Council was divided, with nine member states (including four of the new members) reportedly voting against and nine in favour, and a number of abstentions.⁶⁰ Although the Commission remained free to take a positive decision in the absence of Council agreement, this case once again demonstrated the persistent divisions in the Council on new approvals. Significantly, these two cases also seemed to dispel some initial concerns that the new member states—most of which were already engaged in the cultivation of GM crops, often without adequate controls—might serve as a "Trojan horse" for the United States and the biotech industry.⁶¹ Ensuring adequate testing facilities in the new member states does indeed remain a challenge

58 As one US official put it, "The approval of a single product is not evidence that applications are moving routinely through the approval process in an objective, predictable manner based on science and EU law, rather than political factors." Quoted in Anthony Browne, "Protests after Europe Ends GM Food Freeze." *The Times*, 20 May 2004, p. 18.

59 The Council decision is still pending at this writing. For good accounts of the debate over the approval of the GT73 rapeseed, see "Biotechnology: EU Member States Fail to Agree on GM-Rape GT-73," *European Report*, 19 June 2004; and Andrew Beatty, "Majority of New EU States Block GMO Approval," *euobserver.com*, 21 June 2004.

60 See "EU Governments Deadlocked over Monsanto's Genetically Modified Corn Product," *Associated Press*, 28 June 2004; and Sharon Spiteri, "Member States Split on GM Maize Approval," *euobserver.com*, 29 June 2004.

61 On the new members as a "Trojan horse," see Paul Brown, "EU Races to Thwart Influx of GM Food from East," *The Guardian*, 14 February 2004. A more detailed but equally critical study is Thomas Schweiger, *EU Enlargement: The Introduction of GMO's by the Backdoor of EU Accession?* (Northern Alliance for Sustainability and Friends of the Earth Europe, May 2003).

for the EU post-accession, but it seems clear that the ambivalence toward agricultural biotechnology in the "old" EU is reflected in the public opinion and governmental positions of the new members as well.⁶²

In sum, the European Union's regulatory framework for the approval, tracking, marketing, and labelling of GMOs has been substantially overhauled over the past five years, in the light of both US and WTO external pressures and domestic European pressures. Some of these reforms—such as the increased emphasis on scientific risk assessment by the EFSA and the *de facto* end of the moratorium on new approvals—appear to be responses to international pressures, adopted in the hope of mitigating or forestalling WTO legal challenges (Skogstad 2001; Scott 2003). Nevertheless, by contrast with the US, the EU retains a system in which GMOs are regulated according to process rather than product standards, where strict regulations on traceability and labelling now impose new and unprecedented constraints on GM foods and crops, and where "risk management" remains in the hands of political bodies which remain free to take decisions according to social and economic as well as scientific criteria. There is therefore little evidence, on balance, of convergence of the EU regulatory system on that of the United States.

B. Review of US Regulatory Developments

What, then, of the United States? If the EU has not converged on the American system of relatively science-based regulation by independent agencies, have US regulations and the US regulatory system converged on that of the EU? Or in David Vogel's phrase (1995), has the United States "traded-up" to EU standards in order to gain access for US farm products to the EU market? As Alasdair Young (2003: 458) points out in a sophisticated analysis, the question of US "trading up" requires us to distinguish analytically among three inter-related phenomena: (1) "commercial adaptation," which occurs when US firms or farmers voluntary comply with EU standards (e.g., growing only EU-approved GM varieties) in order to gain access to the EU market; (2) political mobilization, which occurs when domestic US interest groups, spurred on (at least in part) by events in Europe, mobilize for stricter GM regulations; and (3) policy change, when US authorities adopt stricter framework legislation or stricter implementing regulations. As Young (2003: 46) points out, the last type of change is the most demanding, since in the GMO case it would require not only the adoption of specific regulatory standards, but a significant change in

62 A survey of citizens of the EU's ten new members conducted in 2003 showed that sixty-eight percent held negative views toward GMOs, a result roughly similar to surveys of citizens of the "old" Europe. "Genetically Modified Food." *Economist*, Apr. 3, 2003, at 5 A second major change in the European Union, the constitutional treaty agreed in Brussels in June 2004, does not alter the substance of EU policy or policy-making with regard to agricultural biotechnology, and is therefore unlikely to affect policy toward GMOs if it is ratified and comes into force.

the regulatory style and framework outlined above. In fact, a careful examination of recent US events (reflecting and updating Young's analysis) provides some evidence of commercial adaptation and political mobilization. However, policy changes largely reflect an incremental elaboration of the traditional US system rather than any regulatory overhaul in the direction of the EU approach.

With regard to commercial adaptation, Young finds some evidence of US farmers and growers' associations taking decisions on which crops to plant based at least in part on the regulatory standards of the EU and other target markets such as Japan and Canada. The National Corn Grower's Association, for example, has established a "know before you grow/know where to go" program to advise farmers about the GM varieties accepted in various foreign markets, and Young points to evidence that US farmers have concentrated production in those varieties of GM corn and soybeans approved for marketing in the EU (Young 2003: 468-70). Farmers' concerns about market reception have been even more striking in relation to the controversy over the introduction of Monsanto's GM wheat. The new variety, a "Roundup Ready" wheat resistant to the Roundup herbicide, was submitted for regulatory approval by Monsanto in the US and Canada, only to encounter widespread concern among farmers concerned that approval and adoption of GM wheat could imperil their markets in the EU and other countries.⁶³ Under the circumstances, Monsanto promised to wait for regulatory approval in both the US and Canada (the largest exporters of wheat) as well as Japan (one of the largest importers) before moving ahead with field trials. Finally, on 10 May 2004, the company announced that it was "deferring all further efforts to introduce Roundup Ready wheat."⁶⁴

The commercial prospects for GM foods and crops in the United States, therefore, remain unclear at this writing. On the one hand, US farmers have showed little inclination to abandon established GM varieties, with the total acreage devoted to GM crops rising by some 15% in 2003, to include 81% of soybeans, 73% of cotton, and 40% of corn.⁶⁵ On the other hand, GM production in the United States

63 Several industry associations, including the National Association of Wheat Growers, called for a reliable system for segregating and tracing crops before GM wheat was introduced. In the words of the vice-president of the North American Millers Association, "Our customers are telling us that they have very serious concerns or are flat-out opposed to GM wheat.... While this opposition may have nothing to do with science, the customer is always right." Jim Bair, quoted in Pew Initiative on Food and Biotechnology, "A Wheaty Issue: GM Wheat Enters the Regulatory Arena," <http://pewagbiotech.org/buzz/display.php3?StoryID=96>, accessed on 3 April 2004. See also Pollack 2004b.

64 Monsanto Company, "Monsanto to Realign Research Portfolio, Development of Roundup Ready Wheat Deferred," <http://www.worc.org/pdfs/monsantodropsPR.pdf>, accessed on 11 June 2004.

65 Pew Initiative 2004: 3 (citing figures for 2001-2003).

was increasingly concentrated in these three core crops, while notification of new varieties and commercial acceptance of other GM crops (including various fruits and vegetables) had decreased from the rapid pace of the late 1990s (Pollack 2004a).

With regard to political mobilization, there is considerable evidence to suggest that media attention given to the US/EU dispute influenced the activities of consumer and environmental groups in the United States, as well as public opinion about GMOs. Prior to the onset of the dispute, US consumers had indicated virtually no opposition to—and indeed virtually no awareness of—the existence of GM foods and crops.⁶⁶ Following the outbreak of the dispute, as well as the opportunity for US interest groups to interact with their European counterparts in the transatlantic consumer and environment dialogues, consumer groups such as Ralph Nader's Public Citizen and environmental groups such as the Sierra Club adopted publicly critical positions toward GM foods and crops, pressing for stricter regulations and mandatory labelling of GMOs.

Public opposition to GM foods and crops was fed as well by internal US developments. In the May 1999 issue of *Nature*, Cornell University researchers reported that laboratory tests had shown that the use of a genetically modified Bt-corn variety could kill not only targeted pests, such as the corn borer, but also Monarch butterfly larvae were the corn variety's pollen to travel to nearby milkweed, the larvae's source of food (University of Illinois 1999: 95). In the monarch butterfly, the Bambi of the insect world, opponents of genetically modified foods suddenly found a potentially powerful rallying symbol. The following year, in October 2000, the first major GMO scandal emerged when Starlink corn—a GM variety marketed by Aventis and approved for use in animal feed but not for human consumption—was found to have worked its way into the food supply, turning up in Taco Bell taco shells and causing allergic reactions among some consumers. The Starlink incident, which led to a major recall of the corn by Aventis, also stoked the debate over GM foods and over the adequacy of US regulatory oversight.⁶⁷ In response to consumer concerns, some US retailers—including Whole Foods supermarkets, Gerber and Heinz baby foods, and the makers of Frito-Lay corn chips—followed their European counterparts in announcing that henceforth their products would be GMO-free.

66 Surveys showed that while approximately 60% of processed foods consumed in the United States contain genetically modified seeds, only about 33% of Americans even knew that genetically modified foods were available in supermarkets, and 60% claimed that they would not buy foods labeled to contain genetically modified ingredient. See Hill and Battle 2000.

67 "Furore over Starlink Triggers Regulatory Rethink," *Bridges Weekly Trade News Digest*, Vol. 4, No. 45 (28 November 2000). See also the discussion in Lawrence Busch, et al., *Amicus Curiae Brief: Submitted to the Dispute Settlement Panel of the World Trade Organization in the Case of EC: Measures Affecting the Approval and Marketing of Biotech Products*, 30 April 2004, pp. 34-35.

Despite this substantial mobilization, there is little evidence that US public opinion is converging on the deep distrust toward GMOs among European publics. A September 2003 poll for the Pew Initiative on Food and Biotechnology, for example, indicated that GM foods and crops had become a less salient issue for Americans as compared to a previous poll two years earlier (immediately following the Starlink controversy), and that opposition to GM foods remained but had weakened during that period. Perhaps most strikingly in contrast with the European Union, poll data indicated weak support for a complete ban on GM foods, together with high confidence in the FDA's regulatory competence. In the survey, for example, only 28% of respondents agreed with the statement, "genetically modified foods should not be allowed to be sold even if the Food and Drug Administration believes they are safe," while 64% disagreed; and other results indicate strong public support for the regulatory role of the FDA.⁶⁸

With regard to regulatory change, finally, recent years have witnessed a significant debate among US legislators and regulators about possible reforms of the US regulatory process. Within both the US Congress and in various state assemblies, legislators have introduced dozens of bills with a potential impact on the regulation of biotechnology, including bills sponsored by Representative Dennis Kucinich (D-Ohio) and Senator Barbara Boxer (D-California) that would introduce mandatory labelling for all GM foods. These legislative initiatives have so far failed, however, and the few modest measures that were adopted at the federal level have merely instructed the US executive to support biotechnology internationally.⁶⁹

In the absence of any major legislative changes, the FDA and the USDA have conducted hearings and studies to consider administrative changes to the regulatory existing system, including the possibility of introducing mandatory labelling or pre-approvals of new GM varieties. In 1999, for example, the FDA held public hearings on the regulation of GM foods and crops, during which it received more than fifty thousand written submissions regarding the agency's rules on the approval and labelling of GM foods. After several years of collecting and analyzing these submissions, however, the agency rejected arguments for mandatory labelling, which it continued to hold were not required under the Federal Food, Drug and

68 Interestingly, the results also indicate that respondents are consistently more supportive of genetically modified plants than of genetically modified animals, which suggests that public support for bioengineering may be negatively affected as the latter proceed through approvals to marketing in the United States. See Pew Initiative on Food and Biotechnology 2003; Mellman Group, 2003.

69 For a detailed listing of biotech-related legislation introduced at the federal and state levels in the United States, see the Pew Initiative on Food and Biotechnology's Legislative Tracker, available on-line at: <http://pewagbiotech.org/resources/factsheets/legislation/index.php>, accessed on 3 April 2004.

Cosmetic Act,⁷⁰ opting instead for the issuing of guidelines for voluntary labelling to indicate whether a product had been made with, or without, the use of bioengineering. At the same time, the FDA announced that it was considering requiring prior *notification* of new GM varieties, and that much of the information provided by companies would be made publicly available; at this writing, however, the FDA has yet to finalize the latter proposal, which in any event falls far short of the EU requirement of prior *authorization* of new GM varieties.

The debate about the regulation of biotechnology in the United States is certainly not over. Many environmentalists and consumer groups continue to press the FDA and Congress for stricter regulation and labelling of GM foods, while others such as the Pew Initiative on Food and Biotechnology (2004) have called for incremental reforms to the system to deal with the imminent introduction of new GM products including plants intended for pharmaceutical use as well as genetically modified animals. The Pew report is particularly noteworthy in that, unlike many European critics of the US system, it does not call into question the fundamentals of the US's relatively science-based system, but rather points to lacunae in the regulatory authority of the three core agencies under existing legislation, particularly with regard to bioengineered animals, and puts forward a menu of possible reforms to clarify and strengthen the agencies' regulatory authority. On 22 January 2004, moreover, the USDA announced its intention to update and strengthen its biotechnology regulations, beginning with a complete environmental impact assessment of the current system as measured against several possible reforms, and called for public comment. "Any proposed changes to the regulations," the announcement noted pointedly, "will be science and risk-based."⁷¹ Reform of the current system is thus likely to remain on the US agenda, resulting in administrative and possibly legislative changes to the current system, yet there is little sign that the United States is preparing to move away from its core practice of science-based regulation by agencies such as the FDA.

70 As the FDA reported, "Many of the comments expressed concern about possible long term consequences from consuming bioengineered foods, but they did not contend that any of the bioengineered foods already on the market have adverse health effects. The comments were mainly expressions of concern about the unknown. The agency is still not aware of any data or other information that would form a basis for concluding that the fact that a food or its ingredients was produced using bioengineering is a material fact that must be disclosed under sections 403(a) and 201(n) of the Act. FDA is therefore reaffirming its decision not to require special labeling of all bioengineered foods" (FDA 2001).

71 United States Mission to the European Union, "USDA Announces First Steps to Update Biotech Rules," <http://www.useu.be/Categories/Biotech/Jan2204UpdateBiotechRules.html>, accessed on 11 June 2004.

VI. The United States' WTO Challenge against the EU's Regulation of GMOs

The United States delayed for years bringing a WTO case against the EU. It finally initiated requests for consultations in May 2003 after President Bush declared the end of "major combat operations" in the second Iraq war.⁷² In August 2003, the United States requested the establishment of a dispute settlement panel, which was formed in March 2004.⁷³ This section is in three parts. The first part addresses why the United States delayed bringing a complaint before the WTO for so long, but eventually initiated one. The second part addresses the United States' claims and the EU's defences under the applicable WTO rules. The third part examines the potential role, if any, of the WTO dispute settlement system in helping to resolve the US-EU regulatory conflict.

A. Explanation of The Delay and Initiation of the US Complaint

Unlike in its earlier challenge against the EU's ban on meat hormones, the United States refrained from bringing a WTO claim over EU restrictions on genetically modified products for years, preferring to conduct bilateral and multilateral discussions. It appears to have initially chosen this less aggressive route for four primary reasons: (i) US authorities, in consultation with US industry, understood that EU authorities were severely constrained by the demands of EU consumers and member state politicians, and believed for a long time that bringing a WTO case might be counter-productive; (ii) there was some risk that media coverage of a WTO dispute over GMOs could adversely affect the political and commercial situation within the United States itself; (iii) following the mass demonstrations at the WTO ministerial meeting in Seattle, US authorities were reticent to initiate a new controversial case involving consumer health and environmental protection, and bided their time; and (iv) European concerns over genetically modified foods appeared to have growing support around the world, as represented by the January 2000 signature of the Biosafety Protocol and new labelling requirements imposed by other countries. The United States waited to see the fallout of these developments. We examine each of these issues below, as well as developments that eventually led the United States to bring the WTO case.

72 President Bush declared the end of hostilities on May 1, 2003 from the aircraft carrier USS Abraham Lincoln. See Karen DeYoung, "Bush Proclaims Victory in Iraq; Work on Terror Is Ongoing, President Says," *Washington Post*, May 2, 2003, at A1.

73 We should hear the result of the WTO panel decision in September or October 2004.

1. *US Recognition of European Consumer Opinion and the Potential of a Populist Backlash*

US authorities and affected US industries recognized that the EU stance was a populist one and that EU authorities' hands had been tied. US industries did not want to be seen as forcing genetically modified foods on European consumers, since the market backlash could be severe, with an increasing number of brand food companies and retail chains forsaking products with genetically modified ingredients. US authorities and companies rather hoped to work with EU authorities and EU scientists to, over time, convince the European public that genetically modified foods are safe and can be beneficial to human health and the environment. Nonetheless, US commercial constituencies became concerned over the slow pace of change in the EU, and increasingly pressed the US government, in particular through Congressional representatives, to bring the case.⁷⁴

2. *Spillover Effects of EU Policy in the United States*

It at first appeared that the media attention given to the US-EU dispute over European restrictions on genetically modified foods could affect the political and commercial playing fields within the United States, triggering greater US regulations of GMOs. As we have seen, however, despite the increased media attention, consumer attitudes did not fundamentally change in the United States, and concerns about an anti-GM backlash in the US had eased. The policy space within the United States was thus relatively clear to bring a WTO case.

3. *The Fallout of the Anti-WTO Seattle Demonstrations*

The Seattle demonstrations in opposition to the launching of a "millennium round" of trade negotiations undercut US strategies to place legal pressure on EU authorities. The demonstrators forced a cancellation of the ministerial's first day of meetings and ultimately the collapse of the ministerial without a mandate for a new round of negotiations. By joining an anti-WTO coalition that rallied a number of constituencies, anti-GMO activists could foment opposition to the administration's hopes to obtain fast-track trade negotiating authority from Congress, and, ultimately, Vice President Gore's candidacy in the November 2000 elections. Moreover, other US commercial interests—including telecommunications, industrial property industries, and other "new economy" sectors—did not wish the United States to trigger further opposition to trade liberalization endeavours on account of another WTO lawsuit over food. In short, this was not an opportune time for the Clinton administration to legally challenge the EU's trade restrictions on genetically modified foods.

74 See "Invasion of the Transgenics," *The Economist*, May 14, 2003.

By August 2002, however, the new Bush administration had received Trade Promotion Authority, the Doha negotiating round had been launched, and anti-WTO protests had somewhat mollified in the wake of the September 11, 2001 terrorist attacks.⁷⁵ In short, the US administration was less fearful that a WTO case could upset its other trade policy and political goals.

4. *Foreign and International Developments*

Finally, as we have seen, the anti-GMO movement was moving beyond the European Union to both advanced industrialized and less developed countries. Among the former, Japan, Korea, New Zealand and Australia joined the EU in adopting stringent GM regulations, while the majority of developing countries, generally concerned over the expansion of patent and other rights over seeds and plant varieties, supported a move toward a potentially restrictive new treaty on genetically modified foods. On January 29, 2000, the Cartagena Biosafety Protocol was signed.

Yet, by 2002, it was clear that the United States had a number of allies in its challenge against European trade restrictions on GMOs. Argentina, Canada, China, South Africa, and Brazil are increasingly adopting GM seed varieties. Together with the United States, they were "responsible for about 99 percent of bioengineered crops around the world" in 2003, when production increased "roughly 15 percent from the year before."⁷⁶ The United States ultimately brought the WTO challenge along with Canada and Argentina, with Egypt dropping out at the last moment.⁷⁷

In short, it appears that the United States finally initiated the WTO complaint because of a combination of (i) increased frustration of commercial constituents over lost sales to Europe, (ii) US commercial concerns over the impact of EU regulatory restrictions on third countries, (iii) US commercial concerns over future GM varieties that the US hoped to market abroad, and (iv) hopes that a WTO case could help influence debates within the EU and elsewhere over GMOs toward more "science-based" determinations. Since anti-WTO demonstrations had somewhat

75 Congress granted the Bush administration trade promotion authority by one vote, subject to numerous conditions, including an expiration date of June 1, 2005, to be extended automatically until June 1, 2007 if neither congressional chamber adopts a resolution opposing extension. See *Trade Act of 2002*, Public Law Number 107-210, § 2103, 116 Statute 933 (August 6, 2002).

76 "Genetically Engineered Crops Up 15 percent; China, South Africa Report Biggest Increases." 21:4 *International Trade Reporter (BNA)* 124 (Jan. 22, 2004) (citing report of the International Service for the Acquisition of Agri-biotech Applications, available at <http://www.isaaa.org>, noting that the United States was responsible for "about 63 percent of the world's bioengineered crops").

77 See Tobias Buck, "Blow to US as Egypt pulls out of modified crops case," *Financial Times*, May 29, 2003.

subsided, since the US administration had obtained trade promotion authority, and since the Doha negotiating round was in process, there seemed to be less of a downside from a WTO legal case compared to the risks of continued European intransigence toward approving new GM varieties and increased EU biotech regulation in general. As USTR Robert Zoellick stated in January 2003, "we've tried to be patient, we've tried to work the system, we tried to pay attention to European political sensitivities. It's not moving. It's not being solved."⁷⁸

B. The WTO Legal Issues

In their May 2003 request for consultations, the complainants Argentina, Canada, and the United States limited their WTO claims to a challenge of the EU's de facto moratorium on approvals of biotech products and member state "national marketing and import bans on biotech products" that had been approved. Agricultural trade associations within the United States, led by the American Soybean Association, have pressed the USTR to initiate a WTO challenge against the EU's new labelling and traceability rules as well. However, there is no indication that such a complaint will be filed imminently. The filing of such a complaint will likely depend on the outcome of the current case.⁷⁹

The three complainants made their initial request for consultations under the Agreement on the Application of Sanitary and Phytosanitary Measures ("SPS Agreement"), the Agreement on Agriculture ("Agriculture Agreement"), the Agreement on Technical Barriers to Trade ("TBT Agreement"), and the General Agreement on Tariffs and Trade 1994 ("GATT 1994"). The United States' initial written submission, however, focused on the provisions of the SPS Agreement, although it "reserved the right" to bring claims under the TBT Agreement. Canada and Argentina also focused on the SPS Agreement, but they set forth cumulative and alternative claims under the TBT Agreement and under Article III.4 of GATT 1994.⁸⁰

78 "Europe Warns US: Hand Off Our Biotech Food Ban," American Federated Press, Feb. 04, 2003, Available at EU Business, <http://www.eubusiness.com/imported/2003/02/102617/view>.

79 See "ASA Takes Lead in Pushing for New WTO GMO Case Against EU," *Inside US Trade*, at 25 (March 12, 2004) (noting that the American Soybean Association is taking the lead in hiring private lawyers to prepare the background for such a WTO challenge). For a legal assessment of how the United States could prevail in a WTO case against the EU's new labeling and traceability requirements, see Mansour and Key, Spring 2004. Mansour and Key work for the Washington D.C. office of Morgan, Lewis & Bockius LLP.

80 Argentina's written submission has not been made publicly available. The EC's public submission, however, responds to arguments made in the submissions of all three complainants. Canada and Argentina set forth their TBT claims either as "cumulative" or "alternative" claims. See First Written Submission by the European Communities, May 17, 2004, at pars. 435-436. The also made claims under GATT article III.4. *Id.*, at par. 518.

The United States' claim is set forth in three parts, in which the United States respectively challenges the EU's "general moratorium," its "product-specific moratoria," and EU member state marketing and import bans. The United States contends that the SPS Agreement applies, since the EC maintains that its measures are needed, on the one hand, to protect humans from toxicity, allergenicity, horizontal gene transfer, and antibiotic resistance, and, on the other hand, to protect the environment from the potential invasiveness of new species, from the development of resistance in pests, and from other unintended effects arising through GMO use. The SPS Agreement covers "measures," including "testing, inspection, certification and approval measures," applied to protect animal and plant life and health from pests and diseases, and human and animal life and health from the risks of additives, toxins, and diseases.⁸¹

The United States challenges "the general moratorium" and "the product-specific moratoria" for violations of SPS procedural and substantive risk assessment requirements. It maintains that the EU imposes "undue delay" in its product and marketing approvals, in violation of article 8 and annex C of the SPS Agreement. It contends that the EU failed to "publish promptly" its "moratorium" in violation of article 7 and annex B of the agreement. It argues that the general moratorium and product-specific moratoria are not based on risk assessments as required under article 5.1, thus also resulting in a violation of article 2.2. The United States points to twenty-eight product-specific moratoria. It claims that in fourteen of them, the EU "has not put forth any risk assessments whatsoever." In the remaining fourteen where the EU undertook risk assessments, it states that "the product-specific moratoria are not based on these assessments," since the "scientific assessments... concluded that there was no evidence that these biotech products would pose a risk to human, animal or plant life or health or cause other damage."⁸² The United States also maintains that the EU applies arbitrary or unjustifiable distinctions in the levels of protection required for GM products compared to products produced with "biotech processing aids," such as enzymes used in the production of European cheeses, which is in violation of article 5.5 of the agreement.

The United States then challenges the nine "safeguard" measures adopted by six member states, which ban the importation or marketing of biotech products that had been approved under Directive 90/220 or Regulation 258/97.⁸³ The United States maintains that these member state measures were also not based on a risk assessment, as required under article 5.1. Moreover, in each case, the "EU scientific

81 See article 1 and annex A, paragraph 1 of the SPS Agreement.

82 First submission of the United States, April 21, 2004, at par. 143, 145.

83 Three of these measures were adopted by Austria (biotech corn products), two by France (oilseed rape), and one each by Germany (corn), Greece (oilseed rape), Italy (corn), and Luxembourg (corn).

committees considered and rejected the information provided by the member States."⁸⁴ Finally, the United States specifically challenges Greece's import ban under article XI:1 of GATT 1994. Article XI prohibits the use of quantitative restrictions, subject to the exceptions set forth in GATT Article XX. Greece's measure expressly "prohibits the importing into the territory of Greece of seeds of the genetically modified rape-plant line bearing reference number C/UK/95/M5/1."⁸⁵

The EU responded that the SPS Agreement in large part does not even apply to the GMO dispute since "the scope of the SPS Agreement is limited." The EU contends that the agreement's provisions "are simply not designed to address [the] risks" posed by GMOs, which "are of a different nature" and were not in consideration when the SPS Agreement was adopted.⁸⁶ In particular, the EU maintains that GMOs are not "additives," "contaminants," "toxins," "diseases," or "pests" within the meaning set forth in annex A of the SPS Agreement, which defines a "sanitary or Phytosanitary measure" covered by the agreement. Rather, the EU states that the focus of Directive 90/220 is "on environmental protection," including long-term risks to "biodiversity," which "fall outside the SPS Agreement."⁸⁷ The EU maintains that the "Biosafety Protocol" was subsequently negotiated "which lays down the most pertinent provisions to any consideration of any problems related to GMOs."⁸⁸

Second, the EU maintains that it has not instituted either a general or product-specific moratorium. Rather, it contends that the complainants "are attacking what they consider to be undue delay in the conduct of the EU approvals system for GMOs" under article 8 of the SPS Agreement.⁸⁹ That is, they are challenging the application of EU procedures, and not the underlying EU legislation itself.⁹⁰ The EU contends, however, that there were no "undue" delays. It rather characterizes the delays in terms of "requests for additional information" related to issues of risk assessments that were sometimes based on changes in EU legislation, and that often resulted from the applicant's tardiness or incompleteness in providing the additional information.⁹¹ These requests for additional information, the EU argues, are legitimate, especially in light of "new technology which is generally untried and

84 *Id.*, at par. 170.

85 *Id.*, at par. 174.

86 First Written Submission by the European Communities, May 17, 2004, at par. 385.

87 *Id.* at par. 416-420.

88 *Id.*, at par. 386.

89 *Id.*, at par. 460.

90 *Cite.*

91 *Id.*, at par. 486.

untested and which is recognized by the international community to have characteristics which inherently require prudence and caution."⁹²

The EU similarly maintains that no "general moratorium" exists, but rather, each application "has been taken on its own merits."⁹³ The EU notes, in particular, that five biotech food products have been placed on the EU market through "the simplified procedure" of Regulation 258/97. It also contends that, since Directive 90/220 has been replaced by a new directive, the complainants' claims have no validity. In the EU's words, "WTO dispute settlement does not provide for remedies in respect of past measures, not least where they are no longer in existence."⁹⁴ The EU characterizes its delayed measures as an "interim approach" required in the context of changing internal EU legislation adapting to ongoing risk assessments of the technology.

In response to claims from Argentina and Canada that the EU measures violate the GATT national treatment provision, article III.4, the EU contends that no violation has occurred because it treats foreign GMOs no differently than EU ones. The key term in GATT article III.4 is "like product," with Argentina and Canada maintaining that GM products and their non-GM conventional counterparts are indeed "like products." The EU responds that "the international Community has, through the Biosafety Protocol, recognized that GM products are such that they require their own, distinct authorization procedure," and thus are not "like" products.⁹⁵ It concludes that Canada and Argentina have failed to establish "that the product-specific delays provide 'less favourable treatment' for imported GM products as compared with domestically produced GM products."⁹⁶

Finally, the EU characterizes the member state "safeguards" as "provisional and temporary" measures in compliance with article 5.7 of the SPS Agreement. The EU contends that the term "reasonable period of time" as used in this provision is contingent on the circumstances and in light of the level of acceptable risk which "prudent and rational legislators" have determined "on the basis of the pertinent information."⁹⁷ The EU likewise contends that the SPS Agreement does not fully apply to the member state "safeguards" on account of the agreement's limited scope.

92 *Id.* at par. 488. The Amicus Brief of Lawrence Busch, Robin Grove-White, Sheila Jasanoff, David Winickoff, and Brian Wynn, agrees, maintaining, "what looks like 'delay' in one regulatory culture may be '*bona fide* prudence' in another." Amicus brief, at 37.

93 *Id.*, at par 546.

94 *Id.*, at par. 551.

95 *Id.* at par. 535.

96 *Id.* at par. 538.

97 *Id.*, at par. 605-606, 664.

C. The Potential Role of the WTO Case

For many commentators, the SPS Agreement is a problematic one. A simple reading of the SPS Agreement could be that WTO rules require that "science" always trump politics in national (and, in the EU case, regional) regulatory policy.⁹⁸ Such a reading would surely raise concerns about a "democratic deficit" in the design and application of WTO rules.⁹⁹ As Robert Hudec has pointed out:

Traditionally, trade agreements have focused on eliminating discrimination against foreign trade by disciplining governmental measures that impose competitive disadvantages on foreign goods vis-à-vis domestic goods with which they compete. In the recent Uruguay Round trade agreements, however, it appears that the draftsmen [...] added another goal, one that can be described as the prevention of unjustified regulation per se, whether or not such a regulation creates a competitive disadvantage for foreign goods vis-à-vis domestic goods. Thus, for example, a food safety measure that is not based on scientific principles would be a violation of Article 2 of the [SPS Agreement], whether or not it discriminates against foreign goods.¹⁰⁰

These new WTO rules, however, are subject to legitimate challenge in that democratic governments, in response to constituent demands, may decide for multiple reasons to regulate in a manner that is not rationally justified according to most scientists, but is nonetheless not discriminatory. As Hudec points out, a WTO rule that requires regulatory "rationality" can provide "foreign traders [...] a greater set of legal rights than is given to the domestic producers with whom they compete."¹⁰¹

The WTO Appellate Body has, however, responded to some of these concerns over the SPS Agreement in its jurisprudence. The Appellate Body has appeared to provide significant discretion for domestic regulatory policymakers. In the *EC-meat hormones* case, for example, the Appellate Body stated that, under WTO rules,

98 On the notion that science is not purely objective and value-free, see Walker 1998; Wirth, 1994 at 857-859. See also Amicus Curiae Brief of Lawrence Busch, Robin Grove-White, Sheila Jasanoff, David Winickoff, and Brian Wynn, at 12 ("According to a growing body of social scientific research and expert panel reports, judgment enters into both risk assessment and risk management").

99 See Amicus Curiae Brief of Lawrence Busch, Robin Grove-White, Sheila Jasanoff, David Winickoff, and Brian Wynn, at 7 ("The GMO dispute implicates not only technical concerns about barriers to trade but also political concerns about a democratic deficit in the design and operation of the WTO itself"). Compare Guruswamy, 2002 at 497. ("the risk assessment procedures under the SPS Agreement are fair and reasonable and are qualitatively superior to the precautionary principle embodied in the Biosafety Protocol").

100 Robert Hudec, "Science and 'Post-Discriminatory WTO Law,'" 26 *Boston College Int'l & Comp. L. Rev.* 186, 187 (2003).

101 *Id.*, at 188.

members retain discretion to determine the level of appropriate risk. It confirms that members may rely on minority scientific opinions, and can take account of "factors which are not susceptible of quantitative analysis by the empirical or experimental laboratory methods commonly associated with the physical sciences."¹⁰² In the *EC-ashbestos* case, the Appellate Body found that risk factors alone can differentiate products that are otherwise similar.¹⁰³ As Alasdair Young and Peter Holmes conclude,

The approach of the Appellate Body in clarifying the SPS Agreement and other related texts essentially affirms the right of the EU to choose whatever food safety objectives it wishes... The combination of the clarification of the WTO's rules and the development of the EU's food safety policy making, particularly greater reference to risk assessment, should *ceteris paribus* mean that new EU rules are less likely than in the past to fall foul of its WTO obligations.¹⁰⁴

In sum, WTO jurisprudence appears to require the EU to apply a procedural approach pursuant to which decision-makers must rationally take into account risk assessments in pursuit of their regulatory objectives. As the Appellate Body wrote in the *Japan-Varietals* case, "whether there is a rational relationship between an SPS measure and the scientific evidence is to be determined on a case-by-case basis and will depend upon the particular circumstances of the case, including the characteristics of the measure at issue and the quality and quantity of the scientific evidence."¹⁰⁵

This dispute highlights the issue of the potential role of the WTO dispute settlement system in the governance of transnational conflicts over the regulation of

102 See Appellate Body report, *European Communities—Import Restrictions on Meat and Meat Products (Hormones)* WTO Doc WT/DS26/AG/R, at par. 253. See discussion of this decision in Petros Mavroidis, "The Trade Disputes Concerning Health Policy between EC and the US," in eds. Petersmann and Pollack (2003).

103 See Appellate Body report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WTO Doc WT/DS135/AB/R of 12 March 2001, especially at par. 122.

104 See Alasdair Young and Peter Holmes, "Protection or Protectionism? EU Food Safety Rules and the WTO," in eds. Ansell and Vogel. Mavroidis and Howse conclude that "The structure of EU regulation as reflected in the amended directive raises few serious risks of violating the SPS Agreement." See Howse and Mavroidis (Nov.-Dec. 2000).

105 See *Japan: Measures Affecting Agricultural Products, Report of the Appellate Body*, WT/DS76/AB/R (Feb. 22, 1999), at par. 84. Similarly, in the EC-meat hormones case, the Appellate Body stated that: "The requirement that an SPS measure be 'based on' a risk assessment is a substantive requirement that there be a rational relationship between the measure and the risk assessment." *Hormones*, Report of the Appellate Body, at par. 163. The AB further maintained that "determination of the presence or absence of that relationship can only be done on a case-to-case basis, after account is taken of all considerations rationally bearing upon the issue of potential adverse health effects." *Id.*

risk. In our view, the WTO judges, and in particular, the members of the Appellate Body see their role not only as interpreters and appliers of WTO legal provisions. The pattern of their jurisprudence suggests that they also assume a mediating role to induce members to take account of each others' views and interests, and to spur the settlement of disputes, including by facilitate members' compliance with WTO rules, or settlement of disputes in the context of WTO rules, thereby upholding the overall WTO legal system.¹⁰⁶

WTO judges' concern over the legitimacy of their judicial decisions will likely shape their judgment of the GMO case. By legitimacy, we refer to the social acceptance of WTO decisions, and, in particular, the acceptance of legal decisions by WTO members. The EU is the largest trader in the world. Were the WTO Appellate Body to come down hard on the EU in the GMO case, the EU would likely not be able to comply with its requirements. Such a ruling could provide fodder to anti-globalist challenges to trade liberalization, and fuel further mass protests against the organization. It could also provide a rationale for other WTO members not to comply with the Appellate Body's legal rulings. One non-compliance could trigger tit-for-tat strategies of non-compliance. As McDougal and Lasswell wrote about international law over forty years ago, "Since the legal process is among the basic patterns of a community, the public order includes the protection of the legal order itself, with authority being used as a base of power to protect authority."¹⁰⁷ The Appellate Body and judicial panels can help uphold the system by shaping their decisions to induce compliance or amicable settlement.

In our view, it is likely that the Appellate Body will tread softly and wish not to be seen as second-guessing the EU's risk assessment and management decisions. As a result, the WTO ruling could take a procedural turn, in line with the procedural turn in the EU's regulation of GMOs.¹⁰⁸ Even if the United States prevails on some of its procedural claims, we believe that the WTO decision, at a minimum, will leave significant discretion to the EU in determining the level of acceptable risk.

The WTO legal process nonetheless can serve a positive role in the ongoing transatlantic and global conflicts over the regulation of agricultural biotechnology. First, WTO rules arguably have already made the EU decision-making process somewhat more flexible, as they have pushed EU and member state authorities, directly, and European constituencies, indirectly, to justify their decisions over biotech regulatory measures. By providing a framework of legal rules, the WTO can facilitate dialogue between governments and constituencies concerning the objectives of GMO regulation, the means used to achieve these objectives, and the

106 See Shaffer, 2004.

107 McDougal, Myres & Lasswell, 1959: 10.

108 See also Bohanes, 2002:323-389.

impact of these choices on different constituencies.¹⁰⁹ WTO rules, in particular have already pressed the EU not simply to ban all GMOs, but rather to engage in case-by-case risk assessments and the adoption of a new labelling regime. In our view, non-discriminatory labelling rules, in particular, should survive a WTO legal challenge.¹¹⁰ In this sense, WTO rules press parties to justify their decisions and thereby potentially facilitate, in a diffuse manner, rational exchange between governments at the international level, and between governments and their constituencies nationally.

It is not coincidental that the EU finally approved a biotech variety for the first time since the start of the moratorium in 1998 in May 2004, in the middle of the WTO case. The WTO case provided the European Commission with a sense of justification to approve the GM corn variety over member state reticence. Of course, the member states can again reject that decision by implementing national bans. However, the WTO case could facilitate the approval and marketing of some biotech products in the EU more quickly than otherwise would occur. Over time, to the extent that European constituents feel at greater ease with biotech products, the potential for ongoing policy adaptation is left open. We are not predicting, by any means, a convergence of US and EU approaches toward GMOs. However, the WTO legal framework, to the extent that it is applied in a manner that leaves for considerable member state flexibility, potentially can facilitate transatlantic dialogue and adaptation.

VII. Conclusion: Bargaining, Deliberation, and the Choice of International Governance Mechanisms

The regulation of genetically modified foods and crops has been, and continues to be, one of the most difficult and intractable disputes in the US/EU economic relationship. Beginning in the late 1980s with the establishment of their respective frameworks for regulating agricultural biotechnology, the US and the EU have regulated GM foods and crops very differently, and these differences have manifested themselves substantively in terms of longer authorization times and stricter standards for approval, release, and marketing of GMOs in the EU than in

109 Similarly, Rob Howse writes, "SPS provisions and their interpretation by the WTO dispute settlement organs [...] can be, and should be, understood not as usurping legitimate democratic choices for stricter regulations, but as enhancing the quality of rational democratic deliberation about risk and its control." Howse 2000:2329-2330.

110 See also Macmillan and Blakeney, spring 2001: 113-114. (finding that "the issue of labeling of GM foods falls more properly within the ambit of the TBT Agreement," and that "at a time when the WTO is facing unprecedented, and increasingly well-organized opposition, the revelation that the WTO was antagonistic to the labeling of GMOs in food would be a publicity nightmare.").

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the US. More important than any specific regulatory standard, however, is the fact that the GMO dispute brings into confrontation two distinctive *systems* of risk regulation. On the US side, the long-standing system of relatively science-based regulation is not without its critics, but nevertheless has the strong support of farmers, industry and government officials, as well as an impressive degree of social legitimacy in US public opinion. On the EU side, European publics and institutions have from the beginning favoured a more cautious approach to GMOs, including the establishment of specialized procedures to regulate GM foods and crops in terms of the process by which they are made, and the subsequent food safety scandals of the 1990s increased the resolve of EU member governments to put in place ever more strict regulation for the pre-approval, traceability and labelling of all GMOs independent of their individual safety characteristics.

Under the circumstances, efforts to bridge the gap between the US and the EU through bilateral regulatory cooperation—in the hopes that US and EU regulators would engage in joint scientific deliberation and come to common understandings of their regulatory tasks—have been almost uniformly disappointing. While EU observers in particular have expressed optimism regarding such deliberative approaches to public policy-making, most theoretical accounts of deliberative decision-making concede that genuine deliberation is most likely *under certain scope conditions*, including depoliticized and often *in camera* settings, where state representatives enter discussions in a mutual search for truth.¹¹¹ By contrast, the regulation of GMOs is a highly politicized issue-area in which US and EU representatives negotiate in the light of strongly mobilized domestic opinion, and in which the negotiators themselves often believe strongly in the superiority of their own regulatory system. In Thomas Risse's (2000) language, these conditions are far more conducive to "bargaining" than to "arguing" (deliberation). In this context, it is not surprising that the most productive of the transatlantic dialogues on biotechnology—the 1999 Biotechnology Consultative Forum, and the TACD meetings and working groups—have been undertaken either by experts participating in their personal capacity, or by like-minded activists under no constraint to represent their respective countries. By contrast with these two cases, the official bilateral dialogues and the three multilateral negotiations examined in part 3 of this paper (the WTO discussions, the Biosafety Protocol, and the Codex Alimentarius Commission) were all textbook cases of "bargaining," with both sides seeking to negotiate on the basis of fixed positions and both jockeying for advantage by exporting their preferred models to the global stage and thereby influencing the outcome of future negotiations or litigation. In the absence of any meaningful

¹¹¹ The literature on deliberation in EU and international politics has mushroomed in recent years, and we do not do justice to it in these brief comments. For some foundational texts, see Joerges and Neyer 1997; Risse 2000, 2001; Checkel 2000; and Joerges 2001.

deliberation, however, each of these forums has thus far yielded little clarification but rather inelegant compromises that obscure rather than clarify the nature of the differences in question. This is not to say that bilateral or multilateral dialogue is fruitless, since even "bargaining" can result in useful exchanges of information and sometimes mutual accommodation; but initial hopes for transatlantic deliberation and convergence in such forums have clearly faded with the passage of time.

Against this backdrop, the US complaint before the WTO Dispute Settlement Body presents significant risk of backlash against GMOs or the WTO, or both—risks of which we have warned at length (Pollack and Shaffer 2001). Yet the US case also holds the promise of clarification and legal certainty that nearly a decade of bilateral and multilateral negotiation has failed to produce. As we have seen, previous WTO rulings (most notably in the beef-hormones case) have already clarified the obligations of all parties in undertaking risk regulation, with particularly evident effects on the regulatory processes of the European Union (Mavroidis 2003; Skogstad 2001; Scott 2003). In a similar fashion, the legal setting of the Dispute Settlement Body has already forced both sides in the current dispute to argue their respective cases in the language of international law. Should the WTO panel (and, in all likelihood, the Appellate Body) produce a ruling that provides clarity about the obligations of each side without provoking a backlash in domestic public opinion and calling into question the legitimacy of the WTO itself, then the significant gamble of bringing a WTO complaint may well have paid off.

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Comments

Christian Joerges

No issue in the trade relations between the US and the EU is more contested than that of genetically modified organisms. Gregory Shaffer and Mark Pollack have delivered substantial contributions to that multi-faceted debate.¹ My comment cannot but be selective. The focus I have chosen for this comment mirrors the interests of a lawyer with interdisciplinary ambitions. Thus I concentrate on a methodological issue, albeit one which concerns a particularly interesting dimension of this co-authored work.

Let me take the liberty of starting with a so-to-speak Teutonic, *i.e.*, abstract and systematic, perspective. In a short essay already published 10 years ago, Jürgen Habermas² characterized lawyers' and social scientists' treatment of law and democracy as opening up a kind of schism between the disciplines. Each discipline, he argued, tends to approach law according to its particular logic which cannot be communicated across the disciplinary borders. Lawyers restrict themselves to normative issues (and, specifically, to legal reasoning), whereas social scientists specialize in empirical dimensions (and their explanations). Social scientists tend to perceive law—if they see it at all—from *external* perspectives. They do not engage in the business of a *lege artis* application of rules, but explore their impact on

1 Mark A. Pollack/Gregory C. Shaffer, "The Challenge of Reconciling Regulatory Differences: Food Safety and GMOs in the Transatlantic Relationship", in: M.A. Pollack/G.C. Shaffer (eds.), *Transatlantic Governance in the Global Economy*, Lanham, MD: Rowman & Littlefield 2001, 153-178.

2 Jürgen Habermas, "Constitutional Democracy: A Paradoxical Union of Contradictory Principles?", *Political Theory* 29:6 (2001), 766-781.

society, their effectiveness, or they analyze the implementation or compliance of law. Thus, they tend to avoid the prescriptive dimension of law. Normative issues, as dealt with by lawyers, are an *aliud* to truly scientific operations. Habermas' observation concerned the law of constitutional states and the legitimacy of democratic governance within nation states. But his methodological observations are equally relevant in post-national constellations;³ they concern the realms of European and international law on the one hand, and of transnational governance and international regimes on the other. Accordingly, we can expect Mark Pollack to analyze and explain political processes and decisions whereas Greg Shaffer would look at their "juridification", *i.e.*, the legal framework of political controversies, the contents of legal arguments—with the ambition to tell us who is right or wrong, or even which claims are just or unjust.

This, however, is not exactly what happens in this paper. Mark Pollack the political scientist, and Greg Shaffer the lawyer are clearly convinced that they can and should do what Louis Henkins expected them to do, namely, to listen to and to learn from each other.⁴ Both the realist heritage in American international law scholarship and the readiness of American political scientist to take the impact of law seriously are a strong basis for such orientations. They inform the inquiries into the philosophies underlying American and European regulatory approaches to GMOs. They help the reader to understand how policy issues are framed and translated into legal positions. They illuminate how the shift from political controversy to international litigation occurs. All of this is clearly significant and instructive. But do these inquiries suffice to overcome the schism which Habermas has identified?

Not fully, I submit. Sections V-VII seem most revealing in this respect. In Section V, the paper looks at the degree to which US and EU policies have converged since 2000. The convergence is, however, limited. GMOs are an enormously sensitive issue in Europe. Policy-makers have to mediate between consumer anxieties, economic interests, and broader philosophical debates—to which, unsurprisingly, nobody less than Jürgen Habermas delivered a widely acclaimed contribution.⁵ The positions taken by the EU reflect these controversies—and also reflect the EU's legitimacy problems when seeking to arrive at an authoritative decision. The US are, in this respect, in a legally and

3 Cf. most recently Jürgen Habermas, "Der gespaltene Westen (The Divided West)," Frankfurt a.M.: Suhrkamp 2004.

4 The famous quote reads: "The student of law and the student of politics [...] purport to be looking at the same world from the vantage point of important disciplines. It seems unfortunate, indeed destructive, that they should not, at the least, hear each other", Louis Henkins, "How Nations Behave", Law and Foreign Policy, 2nd ed. New Haven, Columbia University Press 1979.

5 Jürgen Habermas, "The Future of Human Nature", Cambridge (UK) : Polity Press 2003.

institutionally-speaking more comfortable position, but by no means in a politically easy one, as the survey on the intra-American debates documents. What will happen in the WTO dispute settlement procedure which Argentina, Canada and the US have initiated? Mark Pollack, the political scientist, reconstructs the policy framework of the on-going contest instructively. Gregory Shaffer, the lawyer, analyses the transformation of the political discourse into a legal contest with great subtlety. But he hesitates to tell us what will happen. However, confronted with such a quest for prophesy, the legal realist gives in. But he is not speechless. The paper—both authors in this respect—points to trans-political and trans-legal dimensions of the WTO dispute. This body is not legitimated or authorized to hand down a decision on such controversies. The best we can hope for, the paper concludes, would be “a ruling that provides clarity about the obligations of each side without provoking a backlash in domestic public opinion and calling into question the legitimacy of the WTO itself.” Would this be a further step towards the “judicialization” of the WTO dispute settlement proceedings? Or should we interpret the conclusion that legalization remains imperfect? I believe that the findings of this instructive paper can be interpreted in a conflict-of-laws approach to WTO law which distinguishes between the principles and rules that the parties to a conflict can subject themselves to and the conflicts that should definitely not be settled legally. An elaboration of this suggestion, however, would have to go far beyond the limits of this comment.⁶

6 Cf. for an elaboration Christian Joerges, “Juridification Patterns for Social Regulation and the WTO: A Theoretical Framework”, Ms. EUI Florence 2004; Christian Joerges/Christine Godt, “Free Trade: The Erosion of National and the Birth of Transnational Governance”, forthcoming in: Stephan Leibfried/Michael Zürn (eds.), *Transformations of the State?*, Cambridge: Cambridge University Press 2005 (= *European Review* 2005 (13) 1).

Chapter 9

Market Power without a Single Market: The New Transatlantic Relations in Financial Services

Elliot Posner

I. Introduction

American and European banks, insurance companies, asset managers and other financial services companies have long competed in multiple jurisdictions with distinct and sometimes incompatible regulatory systems. Financial authorities on both sides of the Atlantic are seasoned to the classic problems this arrangement often sparks. Since the mid-1990s, however, differences in regulatory approaches have been at the centre of a host of intense and increasingly frequent conflicts.

This paper explores a change in the way American and European officials manage them. While some disputes remain very much unresolved, a clear pattern is emerging. Until three years ago, US regulators jealously guarded their regulatory sovereignty in handling transatlantic disputes. They typically exported American solutions by pressuring, persuading or outmanoeuvring their European counterparts and resisted making accommodations to European demands and proposals. If adjustments were going to occur, European national regulators tended to make them. Recently, by contrast, US authorities have made significant concessions in several high-profile transatlantic conflicts, and there are strong indications this behaviour will continue. European regulators are not achieving all their goals but are doing much better than in the past. Transatlantic relations in financial services, in short, have entered a new stage characterized by mutual accommodation.

What accounts for the cooperation in financial services at a moment when transatlantic relations in general are under unusual stress? I argue that the "EU-US Financial Markets Regulatory Dialogue" launched in May 2002,¹ the Norwalk Agreement of September 2002 and other related new cooperative efforts are products of a fundamental shift in the relative market power of American and European regulators. The primary cause is the creation of an EU regulatory system for financial services, which is transferring authority from the national to the European level. This development, deeply rooted in the politics of regional integration and itself a spillover of the euro's introduction, has led to a more accommodative US stance because American financial services companies that operate in Europe have much at stake in the shape of the embryonic EU financial regulatory regime.

Under pressure from US companies to protect their interests or from EU regulators pressing their own and their constituents' agendas, American officials have had to come to terms with newly empowered counterparts. EU officials now have the potential to affect US firms in ways similar to American authorities' influence over European corporations with US businesses. While European choices may benefit US firms by promoting transatlantic regulatory harmonization, they may just as readily harm them through retaliatory responses. Thus, the construction of a European-level regulatory regime triggered new private sector political behaviour and US regulatory positions and altered transatlantic relations in financial services.

This more balanced transatlantic relationship represents a curious turn. It is difficult to find in the current scholarship on cross-border financial integration even a hint that European-US financial relations were about to be transformed in this way, let alone an explanation for it. Recent accounts expect continued US dominance in global financial regulatory developments for two reasons:² a conceptualization of market power that emphasizes market size and the concentration of financial activity; and statist assumptions that eliminate the possibility that supranational developments may transform the international political economy.

Since the scale of national financial services industries in Europe does not rival those in the US and a single European financial market remains still very much a goal, analysts too readily dismiss the potential relative market power of EU officials in their interactions with US financial regulators. They overlook the possibility that the degree to which foreign firms participate in and rely on a regulator's jurisdiction, not just size or levels of financial activity, may be a source of relative

1 The Dialogue was part of the "Positive Economic Agenda" introduced at the US-EU Summit in May 2002.

2 Simmons 2001 is a leading example.

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market power. US firms operating in Europe must increasingly comply with a single supranational regulatory regime. This regional institutional reform is what has changed in the EU and empowered it in its dealings with the US.

Two EU developments were chiefly responsible for shifting financial regulation from the national to the European level and simultaneously netting US financial firms under what is quickly becoming a single authority. The Financial Services Action Plan (FSAP), proposed in May 1999 and endorsed by the European Council in March 2000, is the proposed list, most of which has already been passed, of new regulations with which European and US firms operating in the EU will have to comply. The second is the Lamfalussy Process, the new formal decision-making procedures that are expediting the creation of new regulations and facilitating their implementation and enforcement. Both EU initiatives, adopted to achieve internal goals and improve Europe's international competitiveness, have created a soon-to-be realized single regulatory regime that will apply as readily to US firms formerly operating under twenty-five different authorities as to European ones.

Anticipating this change and the potential for harmful EU regulations, US firms kept Washington politicians and regulators apprised of European developments and enlisted their assistance in pressing for a new regime that would be coordinated with the American one. In the process, US authorities became more responsive to the demands of European officials, though only after testing the new power realities and their counterparts' resolve. The role of US financial companies was thus a primary transmission mechanism, linking institutional change in Europe to enhanced EU market power and more symmetrical transatlantic financial relations.

In a preliminary empirical evaluation, I compare the historical record of five "hot" issues from the securities market sector³ with hypotheses drawn from the above theoretical argument: accounting standards, corporate board composition, stock exchange screens and the regulation of auditors and financial conglomerates. The empirical evidence offers reasonable confirmation of the constructed market power hypotheses and only weak support for alternative explanations. I find that internal decisions about how to integrate a sector in Europe structures EU-US interactions, constraining and enabling the management of the same issue. In the cases where Europeans have been most ambitious at home (accounting standards and financial conglomerates), US regulators have made the most concessions. In the case where Europeans selected the least ambitious form of integration (governing competition among stock exchanges), US regulators have made none. The two cases stemming from the passage of the US Sarbanes-Oxley Act (rules governing auditors and corporate board composition) demonstrate the extent to which mutual

3 Analysts usually divide the industry into three categories: banking, insurance and securities/investment services, which includes investment banking, brokering and dealing, clearing and settling and managing assets. These old divisions have increasingly blurred.

adjustment has become the new standard. This empirical evidence suggests that variation in the way US-EU regulators manage conflicts does not depend primarily on decisions made only in Washington. I find instead that political decisions made in the EU about how to structure cross-border integration are at least as important as those stemming from the US.

Before developing the constructed market hypotheses and the preliminary empirical evidence in more detail, I give some background on the motives and calculations of financial regulators and on general trends in transatlantic relations in financial services. In the concluding section, I discuss the implications for debates between rationalist and constructivist approaches to the IPE.

II. The Financial Services Industry and the Mixed Motives of Financial Regulators

Policymakers are well aware that financial intermediaries—banks, brokerage houses, asset managers, stock exchanges, insurers and other financial services firms—differ from other companies because of the central role they play in the allocation of capital. Decisions made by these firms strongly affect other industries and economic growth and have far-reaching political and social implications. As John Zysman argued two decades ago, national financial systems come in many flavours depending on who determines the price and allocation of capital. In systems dominated by banks, governments can more easily control which companies receive financing. Those dominated by financial markets leave such decisions to a large number of dispersed investors.⁴ His main point is still relevant today. Alternative types of financial arrangements create different groups of winners and losers and affect the ability of governments to carry out policies. Financial systems help differentiate alternative styles of capitalism. How firms are financed shapes companies and industries and affects the risks citizens must bear, how they save for retirement, where they work, their job security and ability to buy homes, and the disparity between rich and poor.

In the aftermath of WWII, financial arrangements followed highly idiosyncratic national trajectories, reflecting Bretton Woods arrangements that promoted free trade but permitted relatively closed capital accounts. Propelled by new electronic technologies, the lifting of capital controls and regulatory competition, the financial industry has been for decades in a constant state of change, characterized by the blurring of walls between sectors, the creation of new financial assets and markets, and the internationalization of competition.⁵ Indeed, the return of global finance in

⁴ Zysman 1983.

⁵ While internationalization has received much of the attention from scholars, domestic dynamics and structures have been equally important. See Deeg 1999 and Verdier 2003.

the post-Bretton Woods era is in large part about the cross-border integration of this industry—financial intermediaries increasingly competing in foreign jurisdictions.

The clashes that characterize transatlantic relations in financial services are rooted in the industry's complexity and the multiple motives of national officials.⁶ Policymakers weigh competing goals in deciding how and to what degree to open their financial services industries to foreign companies.⁷ On the one hand, well-known benefits of economic internationalization are in some ways similar for national financial services as for other industries—enhanced domestic competition, larger markets for internationally competitive national firms, the spreading of innovation and better uses of resources.⁸ The integration of national financial services also brings benefits special to the industry, at least in the case of rich countries. As manufacturers expand their operations, services and marketing to other countries, internationalization of financial services industries allows them to continue long-nurtured national banking relationships in other settings.

On the other hand, finance is a strategic sector, and policymakers and regulators have good reasons for being cautious about how and to what degree they integrate national financial services industries. Some stem from the economic importance and the international competitive advantages of having a vibrant national financial services industry and the fact that financial markets in many sectors can migrate quickly in the age of fleet-footed capital and split-second electronic transactions.⁹ The industry's importance to rich economies cannot be overstated. Financial services companies contribute to economic prosperity by providing large numbers of well-paid, non-polluting jobs and purchasing large amounts of high-tech electronic equipment. In 2001, banks employed 437,000 workers in the UK,

6 Regulation of financial intermediaries is complex, including not only principles and rules and but also implementation and enforcement. Even the replication of the US rulebook may yield a system wholly incompatible, let alone convergent, with the American one. In the EU, where integration has gone the furthest, contrasting regulatory systems have obstructed deeper integration of national financial sectors at every turn. Of course, regulatory differences have not been the only obstacle. As discussed below, politicians and regulators have not always wanted further integration. See Story and Walter 1997.

7 There is a large literature about the causes and direction of financial regulatory reform. See, for example, Cerny 1989; Moran 1991; Sobel 1994; Vogel 1995; Loriaux, Woo-Cumings et al. 1997; and Laurence 2001.

8 For estimates of the benefits from deeper integration of transatlantic financial services industries, see Steil 2002.

9 The story of the Eurobond market, for example, in which US regulations sent activity to London, continues to haunt American policymakers. Interview with senior staff officials of Committee on Financial Services, US House of Representatives, Washington DC, May 6, 2004. A more recent example is the German government bond future market which migrated to the German-Swiss derivatives market, Eurex, from London's Liffe.

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412,000 in France, 717,000 in Germany, 344,000 in Italy and 1,939,000 in the US.¹⁰ In 2002, insurance companies had 217,500 workers in the UK, 138,700 in France, 248,100 in Germany and 40,000 in Italy.¹¹ Security and commodity brokers and services companies had 743,500 employees in the US in 2001.¹²

In addition to these contributions to employment and economic growth in an absolute sense, policymakers and regulators also recognize the international competitive advantages of a large and robust national financial services industry. International Relations scholars have long included finance as a critical source of relative national power for achieving international goals.¹³ The presence of large financial markets perceived by domestic and foreign investors as secure and fair is, no doubt, an important factor behind the US government's ability to borrow at relatively low rates for long periods of time. It has also been an advantage for US companies, especially those developing and commercializing new technologies with uncertain prospects.¹⁴ The deep and liquid financial markets have also been an important magnet attracting the world's brightest engineers, investment capital and technology to the US. In the 1990s, moreover, the SEC was able to use its market power and prestige as the regulator of the world's largest financial services industry to shape the agenda and organization of the International Organization of Securities Commissions (IOSCO) to a considerable extent.¹⁵ Indeed, the status and power that came with this leading role was an impetus for creating similar types of securities regulators in Germany and other countries where they did not already exist.¹⁶

Policymakers and regulators have a second set of reasons for being cautious about how and to what degree to promote cross-border integration of financial services industries. These reflect the democratic nature of the political systems in which they operate.¹⁷ Not all financial intermediaries benefit from the opening of domestic markets. Some enjoy the rents of protected markets and oligopolistic and monopolistic arrangements. Sometimes, as in the case of stock exchanges, financial intermediaries serve as the hub of multiple tiers of financial activity. Policymakers

10 Source: OECD as printed in Commission 2004a.

11 Source: Comité Européen des Assurances (CEA) as printed in Commission 2004a.

12 Source: US Department of Labor, Bureau of Labor Statistics as printed in SIA 2002.

13 See, for example, Strange 1994, 25.

14 The relative absence of risk capital markets in Europe was a key motivation for a European Commission's 1994 intervention. See Posner 2002.

15 On the SEC's role in IOSCO, see Bach 2004.

16 Lutz 1998.

17 Moran 1991.

and regulators have to balance the benefits of liberalizing cosy old arrangements¹⁸ against the pressures of important constituencies and the possibility that inviting foreign competition will undermine an entire national financial sector.¹⁹

Financial regulators also have statutory obligations to protect investors and minimize systemic risk. While expectations about the rise of institutional investors and newly empowered shareholders have fallen short,²⁰ recent events nevertheless remind us of how quickly politicians and regulators can react to financial scandals. Both the Sarbanes-Oxley Act and EC directives on auditing and market abuse came in response in large part to well-publicized financial malfeasance cases.

With so many possibilities, it is often extremely difficult for foreign regulators to decipher what combinations of goals generate policies. Old fashioned protectionism, a bid for competitive advantage, a genuine belief that liberalization would benefit all and legitimate domestic protections for investors are all possibilities. The mixed nature of motives and the uncertainty about foreign regulators' goals are the background to interactions between regulators deciding whether and how to integrate financial services industries.

III. The Old and the New Transatlantic Relations in Financial Services

National central bankers, treasury and finance ministry officials and securities regulators have for decades interacted in a web of bilateral connections and multilateral forums such as the Bank for International Settlements, IOSCO, the Financial Action Taskforce of the Organization for Economic Co-operation and Development (OECD) and the Financial Stability Forum.²¹ The cooperation tended to be fragmented by sectors.²² In the area of securities regulation since the 1980s, it was driven by the SEC and encompassed primarily enforcement issues.²³ European national and US regulators established bilateral relationships and promoted the

18 The relationships between regulators and financial intermediaries are often symbiotic. Some describe them as meso-corporatist (Moran 1991); others, as regulatory capture (Laurence 2001).

19 These types of concerns, for example, produced the watered-down mutual recognition regime of the 1993 EC Investment Services Directive, which limited national stock exchanges' exposure to cross-border competition. In an infant-industry-type scenario, the directive gave more time to the continental exchanges to improve their competitiveness vis-à-vis the London Stock Exchange and thereby prevented the migration of equity trading and all its associated business to the UK (Steil 1998a).

20 Steil 1996.

21 Bach calls it a transgovernmental regulatory network (Bach 2004). For a contrasting view, see Simmons 2001.

22 The Financial Stability Forum is the exception.

23 Bach 2004.

sharing of enforcement-related information codified in memoranda of understanding.²⁴

In 1997 the SEC's Office of International Affairs began to focus on how to manage increasingly apparent differences in regulatory approaches.²⁵ Paradoxically, regulatory conflicts became more intense in the aftermath of major reforms to European national regulatory systems. The reforms, especially those governing securities markets, had moved European regulatory regimes closer to the American model.²⁶ In fact, vexing conflicts of the late 1990s came about in large part because of this institutional isomorphism. The new similarities changed expectations of European firms and regulators about the prospects for deeper integration and emboldened them to demand that the SEC recognize their regulations. This seemed only right to the Europeans. As US regulations were often perceived as best practice, European regulators were more flexible than their American counterparts in extending exemptions and accepting compliance with US rules as equivalent to their own.

Under the post-war transatlantic regulatory regime, which operated largely under the principles of national treatment and non-discrimination, European banks and insurance companies had gained large market shares in several sectors in the US. They complied with federal and state regulations in part by setting up American entities, occasionally acquiring partial exemptions.²⁷ Inside the EU, the extension of the mutual recognition principle to insurance, banking and investment services regulation in the late 1980s and early 1990s generally helped US firms compete across the continent as it did for European firms. By establishing foreign entities that complied with one national regulatory regime (often the UK's), US companies could operate in any other EU national market. Indeed, US firms became leaders in a number of sectors on the continent, most notably in investment banking.

As the number of European-US regulatory conflicts mounted in the late 1990s, the SEC was no more inclined to share regulatory sovereignty with foreign authorities or make adjustments to American rules than they had been previously when the issues were primarily about enforcement.²⁸ The Europeans reformed their

24 Tafara 2004. These are published on www.iosco.org.

25 Interview with former SEC official, Washington DC, May 20 2004. See, for example, SEC 1997.

26 The reasons for convergence and the degree of change are hotly debated (Cerny 1989; Loriaux 1991; Moran 1991; Pauly 1994; Sobel 1994; Coleman 1996; Vogel 1996; Perez 1997; Story and Walter 1997; Deeg 1999; Adelberger 2000; Ziegler 2000; Laurence 2001; Posner 2002 and Verdier 2003).

27 The SEC's reporting requirements for foreign firms listing on US exchanges (they can reconcile national standards with US GAAP) is an example of a partial exemption from national treatment.

28 Simmons 2001.

regulation of financial services, but they still did not meet US standards—at least in the view of American regulators who believed the current regime of national treatment and non-discrimination worked reasonably well and that exceptions could be used to manage the most costly negative effects of multiple and conflicting regulatory requirements.²⁹ The SEC, moreover, was as effective during the late 1990s as it had been before in getting what it wanted.³⁰ Since the 1980s, it had used a range of strategies to achieve its goals with respect to European regulators, who were often more concerned about their own competition over which national financial centre would emerge as the future financial capital of Europe than about whether they were conceding too much to the SEC's agenda. Its officials used their expertise and prestige to persuade, their markets to cajole and multilateral settings, like IOSCO, to take advantage of divisions among Europeans.

A. The New Transatlantic Relationship

Led and coordinated by the US Treasury and the European Commission, American and European officials have entered a new, more structured relationship that has affected the management of conflicts and, in some instances, produced new regulations and changes to previous ones. The new developments not only added a layer to and changed the tenor of the old country-to-country bilateral and IOSCO interactions but also shifted attention to EU-US bilateralism. The new regime is anchored by the "EU-US Regulatory Dialogue on Financial Services" introduced in May 2002 and also includes negotiations in accordance with the September 2002 Norwalk Agreement and the March 2003 initiated SEC-CESR³¹ cooperative framework.³² Officials at multiple levels of government and in several agencies now engage more frequently and regularly than in the past. There is an observable move away from uncoordinated consultations and ad hoc problem-solving toward

29 The SEC had changed its approach to some degree. Before the late 1980s, for example, the SEC was so domestically oriented that it had minimal interest in how US regulations affected the ability of foreign firms to compete in their home markets. Interview with former SEC official, Washington DC, May 20 2004. Also, new issues, such as the influx of foreign issuers in the US, prompted the SEC to reconsider traditional positions. Interview with SEC staff members, Washington, DC, August 17, 2004.

30 This was true in the US context as well. The SEC worked effectively with the US Treasury, which was under pressure from the Europeans. Interview with former SEC official, Washington DC, May 20, 2004. On the SEC's relative autonomy and power within the US political system, see Bach 2004.

31 The Committee of European Securities Regulators replaced FESCO and is comprised of the EU national securities regulators and a representative from the European Commission. CESR advises the European Commission on securities regulation and coordinates the policies of its members.

32 Tafara 2004.

informal discussions about regulatory developments and even formal negotiations over the harmonization of standards.³³

Whereas in the past US regulators interacted primarily with their *national* European counterparts, today EU member states are also represented by two European-level bodies and the International Accounting Standards Board (IASB). The European Commission, an EU supranational bureaucracy with legislative, executive and regulatory powers, was a catalyst in revamping relations and still plays the most important European role, engaged directly in informal discussions with the US Treasury, Federal Reserve Bank, the SEC and the Public Company Accounting Oversight Board (PCAOB). The Committee of European Securities Regulators (CESR), newly created in June 2001, is now part of regularized interactions with the SEC. The SEC-CESR cooperative framework focuses on managing mutual regulatory risks and coordinating and where possible converging regulatory approaches. Finally, the IASB, the EU's new accounting standards setter, is engaged with its American counterpart, the Federal Accounting Standards Board (FASB), to make the US and the EU's new standards fully compatible.³⁴

In the last two years, visits by high-level financial authorities have given the new cooperative relationship stature and publicity. On the US side, Chairman of the US House of Representatives' Committee on Financial Services Michael Oxley, SEC Chairman William H. Donaldson and his predecessor, Harvey L. Pitt, led delegations to Europe. European Commissioner for Internal Market, Taxation and Customs Frits Bolkestein, has visited Washington several times to meet with Treasury, FRB, SEC and Members of Congress, and Director General of DG Internal Market Alexander Schaub testified before Oxley's committee in May 2004.³⁵ These high officials and politicians laud the new more cooperative relations and claim the discussions and consultations have helped to clarify one another's regulatory systems, anticipate and manage problems and coordinate reforms.³⁶

Underneath the diplomacy and new levels of intergovernmental coordination, a more fundamental change has occurred. Making mutual adjustments has now become a routine part of managing conflicts. National treatment and non-discrimination still anchor the new regime. What is novel, however, is the growing frequency and importance of exemptions, exceptions and examples of both sides making adjustments to new and old legislation to accommodate the laws of the

33 Norris 2004a.

34 In January 2005, the seven-thousand publicly-listed EU companies are expected to adopt a single set of accounting standards for consolidated accounts, produced by the IASB and subject to European Commission endorsement. The IASB, though a private organization, thus represents the EU in the convergence project.

35 Testimony available at <http://financialservices.house.gov/index.asp>.

36 Quarles 2003; Bolkestein 2004; Miller 2004; Nicolaisen 2004; and Schaub 2004.

other. In some areas, like accounting standards, officials are working to develop compatible standards to achieve the explicit goal of a mutual recognition regime.³⁷ A long-time aim of European regulators, this marks a major reversal from the American position. Indeed, as a whole, the transatlantic regime has moved towards a more even balance, whereby US regulators are just as likely to make adjustments as their European counterparts.³⁸ Still in its early days, the regulatory regime governing the transatlantic integration of financial services has changed substantially and triggered more ambitious expectations among firms and analysts.³⁹

IV. Explaining Change

The most remarkable characteristic of the new transatlantic relations in financial services, then, is an observable balance, in which European officials have become relatively more influential. What might account for the new symmetry in transatlantic regulatory relations in financial services? The question presents a conundrum for standard thinking about financial regulation in the international context, which expects US regulators to determine outcomes in large part because they govern the world's largest markets. I focus on two logical flaws with this mainstream view.

First, analysts who focus on the role of market power tend to equate it with market size and the concentration of financial activity.⁴⁰ Simmons, for example, argues that "financial power" is based in large part on the size of capital markets and the concentration of financial activity within national borders and for this reason expects the US (and sometimes the UK) to be able to exercise it. As a financial hegemon, she maintains, the US does not need to adjust its own policies in response to external pressures. Her model instead seeks to explain whether the US will expend resources to achieve its goals or wait for market forces to pressure others to adjust.⁴¹

If the key determinants of US relative market power were size and activity, we would expect American regulators to have made fewer adjustments in recent years. US regulators would have gained power relative to their European counterparts because by most measures the size gap between American and European national markets, either individually or aggregated, has expanded not contracted over the last

37 According to FASB, the two standard setters will overcome differences by selecting the highest quality standard between US GAAP and IFRS. See "Short-term convergence project," www.fasb.org/intl/convergence_jasb.shtml.

38 For one SEC Commissioner's list of recent US adjustments made, see Campos 2003.

39 Steil 2002; SFRC 2004; and SIA 2004.

40 Aggarwal 1985; James and Lake 1989; and Simmons 2001.

41 Simmons 2001, 592-601.

decade. US markets remain by far the largest and deepest for almost every financial asset.⁴² As every recent study attests, the one potential challenge to US capital markets dominance—a single European financial market—still remains very much a far-off goal.⁴³

Market size does not translate directly into market power. Instead, relative market power depends heavily on the degree to which foreign firms participate in and rely on a regulator's jurisdiction.⁴⁴ The international power of US regulators stems largely from the numbers of foreign firms who depend on its financial markets and must comply with their rules. Many major European banks and insurance companies have competed in the US for decades, and judging by the net purchases of US equities by EU investors (\$83,271 million in 2001),⁴⁵ European securities firms also rely on American markets. European and other foreign regulators bend to SEC preferences because they want their firms to be able to continue benefiting from American markets and fear the US regulator's ability to prevent it. As the number of European firms benefiting from American markets has hardly diminished, a focus on the US is not likely to yield an explanation for the more accommodative US stance.

For answers, we must turn to developments at the European-level and this requires challenging statist assumptions. Since the introduction of the euro, policymakers have primarily concerned themselves with finishing the job—understanding the obstacles to a single financial market and the best way to remove them in order to reap the full benefits of a single currency. These concerns, shared equally by euro-zone countries and London, with perhaps the most to gain, led directly to two intertwined EU developments. The Financial Services Action Plan provides the content—the legislation deemed necessary to integrate European national financial services industries—and an ambitious timetable. The FSAP originally had 42 measures that covered nearly every area of financial regulation.⁴⁶

42 Some of the more common measures of market size are industry revenues, number of firms, capitalization, volumes of transactions and internationalization of flows.

43 For a recent example, see Commission 2004a; b.

44 See Aggarwal for a discussion of monopsonistic power (Aggarwal 1985, 29-33).

45 Source: US Treasury Department as printed in SIA 2002.

46 This is a classic case of spillover. The European Commission bundled together a wish-list of proposals for financial legislation, some traceable to the 1960s and '70s. They used the "euro" issue to win the support of Ecofin, arguing that the lack of integration in financial services prevented the Europe from reaping the full benefits of a single currency. Interview with European Commission official, Delegation of the European Commission, Washington DC, May 5, 2004.

As of May 2004, EU policymakers had almost completed the original list as well as a few additional measures.⁴⁷

Attention has now turned away from the framework laws to the production of detailed regulations, implementation, enforcement and correcting poorly performing legislation.⁴⁸ These are the core subjects of the second EU reform, the Lamfalussy Process, the new formal decision-making procedures for expediting the creation of EC legislation for insurance, banking and investment services and coordinating implementation and enforcement.⁴⁹ In addition to these formal procedures, the new process created new European-level bodies.⁵⁰

Consumed with the effects of these twin developments on Europe, policy analysts have paid scant attention to their international implications.⁵¹ This is in part because they have made an implicit assumption that enhanced relative market power for the EU would remain elusive until it had financial markets equal to those of the US. For political scientists, however, the oversight is largely a consequence of traditional statist assumptions that downplay the potential independent effects on state behaviour of supranational developments.⁵² Simmons' model, for example, only includes national regulators and treats international institutions as tools of US foreign policy.⁵³

Considering how US firms are likely to react to recent EU institutional change reveals the limits of statist reasoning and the merits of expanding assumptions to allow for the independent effects of supranational variables. Large American securities firms make approximately 20 percent of their net revenues from the 15 original EU markets, close to double the same number from Asia.⁵⁴ By creating a

47 Among the more important pieces of legislation already adopted (though not in every case implemented) are European Company Statute (October 2001), Money Laundering Directive (November 2001), Directives on UCITS I and II (January 2002), Regulation on International Accounting Standards (July 2002), Market Abuse Directive (January 2003), Directive on Occupational Pensions Funds (June 2003) and Prospectuses Directive (July 2003).

48 See Hertig and Lee 2003; Dombey 2004; and FT 2004.

49 Originally, the Lamfalussy Process only included the securities industry. It now includes banking and insurance as well (Lannoo and Levin 2003).

50 The adoption of the Lamfalussy Process remains contentious among the EU institutions and rests on a tentative bargain between the EP, the Council and the EC. Because the process created and relies heavily on the European Securities Committee, it opened a "procedural Pandora's Box." See Dinan 2002.

51 For example, see the publications listed on the Centre for European Policy Studies website (www.ceps.be).

52 For examples of work in this tradition, see Mearsheimer 1990; Keohane and Martin 1995; and Moravcsik 1998.

53 Simmons 2001, 597.

54 See SIA's policies positions toward EU capital markets at www.sia.com.

single set of rules with which US financial services companies operating in Europe have to comply, EU regulators will affect the ability of US firms to compete in the same way that American authorities have long influenced European companies. Before the shift to supranational authority, US firms had access to national markets in Europe and were able to circumvent unfavourable national regulations by setting up operations in London or Luxembourg and exercising the principle of mutual recognition. The firms might logically support a single set of rules in the EU but only as long as it did not favour local competitors and was compatible with the US regulations so as to avoid extra compliance costs.⁵⁵ Facing the proposed EU financial integration project, US firms would thus want to ensure favourable reforms in Europe and close EU-US regulatory coordination and, to achieve these, would likely turn for assistance to US politicians and regulators. With the potential to do as much harm to US firms as American authorities have long been able to do to European companies, we would expect EU regulators to find themselves in a much stronger position when bargaining with their US counterparts than in the past. The logic for more balanced relations holds whether American authorities respond directly to pressure from constituent firms or from EU authorities responding to theirs.

The above argument suggests that an increase in EU relative market power would not depend on the completion of a single financial market, however defined, or even the complete harmonization of regulations. We would instead expect the new relative market power to obtain the moment US firms and regulators anticipated the implementation of the EU regulatory regime. The expectations of a single set of rules or the potential to produce them, not the actual implementation, are what are important. I thus argue that regional developments in Europe, not only decisions made in Washington as Simmons and others expect, are important causes of the more cooperative transatlantic relations in financial services.

V. Empirical Evidence and Constructed Market Power Hypotheses

Preliminary empirical evidence from my five-case comparison supports this argument well. I examine how five of the most difficult transatlantic conflicts in financial services, listed in Table 1, have been or are in the process of being managed.

If the argument were correct, we would expect that the way Europeans integrate their own financial services industries affects their interactions with US regulators. The exogenous independent variable is the degree of regional financial integration. Even though the FSAP and Lamfalussy Process are rapidly integrating national

⁵⁵ See www.sia.com/international/html/eu_capital_markets.html and SIA 2004.

Table 1
List and Description of Cases

Issue Area	Description of Conflict
Stock Exchanges	EU demands that US change from national treatment to mutual recognition.
Financial Conglomerates	EU passes new legislation with international spillovers. US firms face high compliance costs because US regulations are incompatible and unable to meet EU equivalency provisions.
Public Company Auditors	US passes new legislation with international spillovers. EU firms face the costs of compliance with multiple regulators. EU demand mutual recognition.
Corporate Board Composition	US passes new legislation with international spillovers. Some EU firms cannot comply with US law without breaking their own national laws.
Accounting Standards for Publicly Listed Companies	EU demands US change from national treatment to mutual recognition.

regulatory regimes, they have not affected every financial sub-sector equally or at the same time. My study thus takes advantage of variation over time and between sub-sectors.

There are several principles for integrating economies. When Europeans use principles such as harmonization or standardization—which mandate or move toward a single set of rules with which US firms must comply—we would expect an increase in EU relative market power and a more accommodative behaviour on the part of US regulators. This is because EU officials would have to set competition rules for foreign firms. Would they have to comply with the new EU-wide rules or would the way they are regulated at home have to meet new equivalency standards? Either way, EU officials could credibly threaten to use their authority in ways that damage the businesses of US firms. I call this type of integration “deep integration,” and it characterizes several sub-sectors covered by the FSAP. By contrast, looser forms of integration such as the principle of mutual recognition do not create a single set of rules for companies operating in the EU, and we would not therefore expect a change in Europe’s bargaining power with the US. This type of integration

typified efforts before the FSAP and the Lamfalussy Process. I summarize these empirical expectations in Table 2.

Table 2
Empirical Expectations

		(t ₂) Expectations for Management of EU-US Conflicts
(t ₁) EU chooses a principle for integration	Loose Integration	No Change in US behaviour. US reluctant to make adjustments.
	Deep Integration	US much more inclined to make adjustments. More balanced relations defined by mutual adjustments.

A. Cross-Border Rules Governing Stock Exchanges Competition

The rules governing competition among stock exchanges have been on domestic agendas in Europe and the US for decades. The public discussions tend to be contentious because the issues go to the core of national financial systems. The key question is to what extent stock exchanges should compete over customers.⁵⁶ At one level are academic debates about the economic efficiency costs of concentrated versus fragmented trading for investors and companies in need of capital.⁵⁷ At another level lie concerns about the public benefits and positive externalities of having a highly concentrated international centre of trading. As mentioned above, stock exchanges can be hubs of financial and entrepreneurial activity and have an extensive political and social impact domestically and globally.

The historical pattern in Europe has tended toward centralization at the national level.⁵⁸ Regional cross-border competition among stock exchanges has followed a chequered pattern. Episodes of unrestrained competition have prompted politically managed efforts to limit the costs for the less competitive exchanges. The heated and drawn-out negotiations that led to the first Investment Services Directive, for example, helped the continental exchanges fend off the LSE's bid to dominate trading in large European companies. Likewise, a venture capitalists foray to create

56 Stock exchange have two main sets of customers: Companies who want to raise capital through and have their shares traded on an exchange, and investors who want to buy and sell those shares.

57 Schwartz 1996 and Lee 2002.

58 For an example of how this process worked in Germany, see Lutz 1998.

a pan-European Nasdaq copy met with a fierce reaction from national exchanges and governments to divert the new sector for entrepreneurial finance back to the national financial capitals.⁵⁹ The most recent example of cross-border competition is the LSE's effort to take away market share in the trading of Dutch stocks from Euronext, the pan-European exchange that combines the Paris, Amsterdam, Brussels and Lisbon exchanges.⁶⁰

In the US, the historical trend towards concentration in the NYSE was interrupted by the unexpected emergence of the rival Nasdaq Stock Market.⁶¹ In the aftermath of the 1987 global stock market crash and again following public scandals concerning market-makers, the SEC revisited the rules of competition governing the trading of Nasdaq stocks. One consequence has been intense competition between Nasdaq's market makers and new firms using electronic communication networks (ECNs). These issues are very much alive and unresolved. Controversy surrounding Nasdaq's proposal in 2000 to introduce SuperMontage, a new electronic trading system, once again brought the issue of competition rules before the SEC and Congress.⁶² The SEC is currently deciding whether to change the long-standing trade-through rule that has prevented similar types of electronic competition from making inroads into the NYSE's trading business.

For almost a decade, stock exchange competition has been a contentious issues in the transatlantic arena as well. The story begins in the 1990s with European demands for a change from the current transatlantic competition based on national treatment to a mutual recognition regime, whereby European stock exchanges would be able to place their screen monitors on traders' desks in the United States and vice versa without having to comply with additional host regulatory requirements.⁶³ It is not surprising that the initiative came from Europe. Three factors motivated the EU's demands. First, stock exchanges in the EU had more competitive electronic trading systems than the NYSE or Nasdaq. This was a legacy of the spurts of cross-border competition over which national financial centre would emerge as the EU's leading city of finance. Second, the EU exchanges wanted to win back trading of the 300 or so European company stocks listed in the US and gain direct access to American investors.⁶⁴ Third, since 1996 Europeans have used

59 See Weber and Posner 2000 and Posner 2002; 2004.

60 Dickson 2004.

61 Congress, the SEC and the NASD introduced an electronic price and trading system in 1971, which became known as Nasdaq, to clean up the scandal-ridden over-the-counter market. At the time, the NYSE wanted nothing to do with OTC types of companies.

62 Labate 2000; Smith and Ip 2000; VandeHei and Eilperin 2002.

63 Franke and Potthoff 1997. Author's interview with Federation of European Securities Exchanges (FESE) official, June 9, 2004, Brussels.

64 For a detailed discussion, see Steil 2002.

the mutual recognition principle to encourage competition among stock exchanges in the EU. Although the results have been decidedly mixed and have prompted a revision of the first Investment Services Directive, European regulators find the principle to be an appropriate means for deepening economic integration.⁶⁵

Nor is it surprising that US regulators have preferred the current regime and resisted making accommodations to the European entreaties. They did so for two overlapping reasons. First, the SEC's primary domestic mandate is to protect investors. It is justifiably concerned about sharing regulatory sovereignty, especially in sectors like equity markets where individuals regularly participate.⁶⁶ The SEC is not only responsible for regulating exchanges operating in the US but also for the companies that list their shares on those exchanges. A mutual recognition regime would require the US regulator to accept that Americans could buy foreign company stocks in the US not vetted by the SEC.⁶⁷ Second, US politicians and the SEC care deeply about the vitality of the NYSE and the Nasdaq and have symbiotic relations with them. Their aims are to balance reforms that might bring benefits against the possibility that changes could undermine the US financial services industry and see financial activity move off shore.⁶⁸

Despite EU pressure and even a threat from the European Commission to turn stock exchange competition into a trade issue,⁶⁹ the SEC has successfully avoided making accommodations. The primary reason stems from the principle by which the EU integrated the sector. The applicable of a mutual recognition regime in Europe,⁷⁰ plagued by controversies over its meaning, created no single set of rules with which US stock exchanges and other providers of trading services would have to comply. For example, London and Brussels both agreed to allow the US Nasdaq Stock Market to set up a European market that could have customers throughout the EU, and US broker-dealers "internalize" continental stocks in London even though the activity is forbidden elsewhere in the EU.⁷¹ As a consequence of this loose form of integration, US regulators, exchanges and financial firms can play one EU regulator against another, and no single European body can make credible threats

65 Steil 1998b.

66 Technically, of course, this is not true as individuals buy and sell stocks via professional intermediaries.

67 The argument is not air tight as Americans can now buy foreign stocks from foreign exchanges via multiple layers of intermediaries. Still, the SEC would be party to these transactions were it to facilitate such trading on US soil. See Steil 2002 for a contrary argument.

68 See Conley 1997 for the potential for US markets to go off shore.

69 Author's interview with European Commission official (Internal Market), June 9, 2004. Brussels.

70 EC Investment Services Directive of 1993.

71 Boland 2001.

that have the potential to harm large numbers of US financial services companies doing business across Europe. Relations remain asymmetrical. In short, adopting the principle of mutual recognition fostered only loose levels of integration in the European equity trading. Without a single set of rules, it did not have significant effects on the EU's relative market power.

B. Financial Conglomerates

The potential harmful spillover effects on US financial firms of the EC Financial Conglomerates Directive was one of the primary factors behind the US decision to participate in the "EU-US Financial Regulatory Dialogue." Even before December 2000, when the European Commission formally opened the directive's consultation period, US financial services companies were concerned about possible negative implications and have not ceased to this day to pressure US lawmakers and regulators to protect their interests.⁷² The conflict appears to be in its final stages. The US has made a significant adjustment to the way it regulates financial services companies and expects the Europeans to deem the changed US regime to meet the EU's "equivalency" standards.

The Financial Conglomerates Directive, adopted in November 2002, requires that the holding company of non-EU companies be subject to consolidated supervision. This means that a single regulator must oversee all parts of large financial conglomerates including the domestic and foreign banking, insurance and securities operations. A home-regulator can be the supervisor under the new directive so long as its regulatory system meets the EU's "equivalency" standards.⁷³

US financial services firms, especially investment banks operating in Europe, have complained loudly and consistently ever since, and US officials have taken no chances in the way they have responded.⁷⁴ The companies have been concerned for at least two reasons. The first is that at the time of the directive's adoption, US supervision was based on a different operating principle and would not have met the new EU standards. The second is that an EU finding of non-equivalency might be extremely harmful to US-based companies because they would face costly and unwanted changes that included accepting an EU authority as its global consolidated regulator.

72 Reacting to the concerns of the US securities industry, the US Congress included provisions in the 1999 US Financial Modernization Act (known as the 1999 Gramm-Leach-Bliley Act) that would allow companies and the SEC to comply with future EU "equivalency standards" (SEC 2003a, 62911).

73 Tafara 2004.

74 See the Securities Industry Association's key issues section at www.sia.com. Also see reports by the Financial Services Roundtable's Global Financial Issues Committee at www.fsround.org.

While still suspicious about European intentions and irritated by the FCD,⁷⁵ US regulators had little choice other than to make their regulations more compatible with the new EU law, forcing far-reaching adjustments that resulted in provisions in the 1999 Financial Modernization Act that enabled the creation of the Supervised Investment Bank Holding Company.⁷⁶ This alternative to the SEC's traditional net capital rule allows securities firms to calculate on a consolidated basis. The SEC can look at the whole capital of a firm, just as its EU counterparts do.

The new rule represents a major change. The American supervision of financial services companies is deeply rooted in the Depression-era Glass-Steagall Act, the consequential industry structure of separate investment and commercial banking firms and the underlying objective of protecting investors. This combination produced the SEC's very rigorous capital requirements for broker-dealers,⁷⁷ a regime distinct from the EU's new system that reflects a different history of consolidated supervision and a banking industry without sharp divisions between lending and securities businesses.⁷⁸

The SEC's rule change demonstrates a remarkable adjustment for a second reason. Because of the fragmentation of financial regulation among different regulators, adopting the investment bank holding company was complicated by the involvement of several other financial regulators. Some have claimed, in fact, that the SEC took advantage of the pressure from the private sector for consolidated supervision to extend its authority, undermining the underlying bargain of the 1999 US Financial Modernization Act (which officially unwound Glass-Steagall).⁷⁹

It is hard to imagine US regulators would have made such a concession if it had had another viable option. The EU's directive deeply constrained the range of choices. Making no adjustments was not an acceptable option for US firms, who successfully lobbied the Congress and found support for their cause in an SEC eager to expand its powers. Making no adjustments would have placed US firms in a precarious position and undermined the SEC role as their primary regulator.

75 Some in Washington believe that the FCD was a UK competitive bid to pressure US global financial firms into making the City of London their home base. Others think the directive reneges on a bargain from the late 1980s whereby US financial firms would use London to access the EU while keeping the SEC as their primary supervisor. The SEC, for its part, never agreed that its previous regulations would not meet EU equivalency.

76 The SEC publicly downplays the adjustments it has made, claiming "the new rules formalize and strengthen" the SEC's role as a consolidated supervisor (Tafara 2004). Also see SEC 2003a.

77 The US system is a source of pride for some SEC regulators who believe it prevented the Drexel Burnham and other financial scandals from turning into much worse crises.

78 Interview with former SEC official, Washington DC, May 20, 2004.

79 Callcott 2003.

C. Public Company Auditors and Corporate Board Composition

The US Congress passed the Sarbanes-Oxley Act of 2002 in response to the Worldcom, Enron, Adelphia and other financial scandals. The rapid reaction to what was potentially a cataclysmic domestic political, financial and economic crisis paid little or no account to the legislation's international effects. Two financial services regulatory issues brought immediate and angry European complaints. US regulators interpreted and implemented the act in ways that have largely accommodated both.⁸⁰

The first has to do with provisions in the act that required foreign auditors of US-listed firms and of foreign affiliates of American companies to register with the Public Company Accounting Oversight Board (PCAOB) and be subject to inspections, investigations and disciplinary proceedings.⁸¹ In 2002, 333 European companies were publicly listed in the US and were audited by 58 EU-based auditors.⁸² Compliance by foreign firms with US rules governing public company auditing was the basis of the previous national treatment/non-discrimination regime. The new laws move away from self-regulation and establish much more rigorous oversight that made compliance for foreign auditors onerous and, at times, impossible. The two main problems were the costs of duplicative oversight and conflicts that put foreign firms complying with US measures in violation of home country laws.

The initial US position was intransigence, a stance that led European economic and finance ministers in June 2003 to support European Commission retaliation.⁸³ After extensive consultations, including exchanges between the PCAOB Chairman McDonough and European Commissioner Bolkestein and Director General Schaub, the board made extensive accommodations in implementing the act. First, it extended the registration deadline to July 19, 2004 from October 22, 2003. Second, PCAOB created a rule allowing foreign auditors to omit information required of US-based auditors if disclosure would violate home country law.⁸⁴ Finally, it has developed a creative cooperative framework with European and other foreign regulators on a "sliding scale."⁸⁵ PCAOB will rely on home-country authorities to varying degrees for carrying out inspections, acquiring information and other requirements of the new law, depending on the compatibility of the latter's regulatory system.

80 Campos 2003 and Tafara 2004.

81 Ross 2004.

82 Ibid.

83 Author's interview with European Commission official (Internal Market), June 9, 2004, Brussels.

84 PCAOB Rule 2105.

85 Ross 2004.

The Sarbanes-Oxley Act affected European firms in a second way. New requirements for corporate board and audit committee independence put some European companies, especially German firms, with US listings in an untenable bind.⁸⁶ If not modified, these companies would have had to decide whether to comply with US rules to keep their listing and direct access to US investors or continue following domestic laws and forgo their US presence. The effected companies have two boards. While management boards have no outside members, supervisory boards have employee representatives. Both compositions violate Sarbanes-Oxley.⁸⁷

The SEC made three main concessions to accommodate these European firms.⁸⁸ First, because the body responsible for auditing within the corporate structure was independent of management, the SEC interpreted German company boards to be compliant with audit committee requirements. Second, the US securities regulator made an exception permitting non-management employees to serve on auditing committees even though such arrangements are forbidden under SEC rules.⁸⁹ Finally, it accepted a broader definition of an "audit committee financial expert" to accommodate home country practice.

Europeans have made accommodations of their own to assist PCAOB make adjustments and to coordinate auditing committee composition with the new US rules.⁹⁰ The more compatible the EC regulatory system, the easier it will be for PCAOB to involve European regulators in the enforcement of US auditing rules and the SEC to accept European corporate governance practices. The European Commission jumped at the opportunity to add another directive to the original FSAP list. The proposed 8th Company Law Directive would introduce in the EU a similar auditing regulatory regime, making cooperation with PCAOB much easier, and also would require the establishment of audit committees with non-executives as currently mandated in the US.

Both sides consider the cooperation displayed in managing the spillover effects of Sarbanes-Oxley to be success stories and are especially pleased by the handling of the auditing regulation dispute, which officials often cite as a model for EU-US relations in financial services.⁹¹ They and outside observers see the conflicts stemming from Sarbanes-Oxley as a major test of the new "EU-US Financial Markets Regulatory Dialogue" and attribute the successful outcomes largely to

86 Steil 2002; and Tafara 2004.

87 Steil 2002.

88 Campos 2003.

89 Tafara 2004.

90 Miller 2004.

91 Bolkestein 2004; Miller 2004; Schaub 2004.

diplomatic skills (especially those of PCAOB Chairman McDonough), new working relationships among authorities and learning on both shores.⁹² While personal skills, relations and consultations made cooperation easier, interpretations that rely on them miss the more fundamental reason for why the US made adjustments in these two cases. After introducing sweeping changes to financial regulations that had the potential to affect negatively European firms competing in the US, American regulators faced the unspoken but real possibility of EU retaliation. Because of the FSAP and the Lamfalussy Process, the EU could creditably threaten to create new regulations that could levy equal harm to US firms operating in Europe. These new constraints, reflecting the EU's increased relative market power, pressured US regulators to make adjustments.

D. Accounting Standards for Publicly Listed Companies

The conflict over mutual recognition of accounting standards is similar in several respects to the stock exchange dispute. It began in the 1990s when the Europeans proposed a mutual recognition regime, whereby EU companies with listings in the US would use national accounting standards and vice versa.⁹³ American regulators showed little interest in mutual recognition regimes or convergence initiatives. The SEC view was that the rest of the world would eventually adopt US accounting standards.⁹⁴ US Generally Accepted Accounting Principles (US GAAP) was already accepted by all EU regulators, and the SEC did not consider European standards and IAS to be as rigorous. The SEC, moreover, made no new accommodations and continues to this day to require European companies listed in the US using non-US standards to reconcile them with US GAAP.

Unlike in the stock exchange dispute, however, the SEC has recently made concessions to the EU in the area of accounting standards, embracing a process intended to harmonize transatlantic standards. In a stunning turnabout, the US securities regulator now embraces convergence, with the ultimate goal being a mutual recognition regime.⁹⁵

92 Author's interview with European Commission official (Internal Market), June 9, 2004, Brussels.

93 Commission 1995.

94 Simmons 2001, 611, fn 93; Bach 2004, Chapter 5, 30; and van Hulle, 6. In 1981, the number of foreign companies registered with the SEC was 173. By 2001 it was more than 1,300 (Accountancy Age 2002).

95 "The FASB and IASB support moving toward a single conceptual framework that would be used by both Boards," said the SEC Chief Accountant in an August 2004 speech. "The work of these two boards, and other national standards setters involved in the IASB process, is an important part of building and maintaining an effective global financial reporting infrastructure. I support global convergence. It's in the best interest of investors" (Nicolaisen 2004). Also see SEC 2004.

The IASB, the new EU standard setter, and FASB, the US standard setter, are deeply engaged in a project aimed to converge US GAAP and IAS/IFRS.⁹⁶ In the Norwalk Agreement, a memo of understanding dated September 2002, the FASB and the IASB pledged to make their existing standards fully compatible and to coordinate future changes.⁹⁷ In addition, because compatibility of standards lies as much in implementation and enforcement as in the similarity of principles, the SEC's Office of Chief Accountant is working closely with the European Commission in preparation for an eventual mutual recognition regime.⁹⁸

The IASB-FASB convergence project, though still in its early days, comprises six initiatives including the exchange of liaisons, research into differences between the two standards, on-going step-by-step reconciliation and a mutual effort to consider both sets of standards before adopting new measures.⁹⁹ Few anticipate a level of convergence that might permit a mutual recognition regime before the advent of EU harmonization in 2005.¹⁰⁰ Nevertheless, the project represents extensive cooperation characterized by mutual adjustments. According to FASB's description of how the two standard setters will overcome differences, "it is expected that a high-quality solution can usually be achieved by selecting between existing US GAAP and IFRS."¹⁰¹

Several factors contributed to the changed behaviour of US regulators. The corporate scandals of the 2000s fuelled a domestic debate about the effectiveness of the US disclosure regime and created a window of opportunity for those in favour of substantial revision and undermined claims of its superiority relative to other standards. The Sarbanes-Oxley Act mandated that the SEC investigate the merits of shifting US GAAP towards a principles-based model and required that US

96 International Financial Reporting Standards or IFRS is the new label for IAS.

97 The text of The Norwalk Agreement is available at www.sec.gov.

98 Tafara 2004.

99 See www.fasb.org/intl/convergence_iasb.shtml.

100 For the SEC Chief Accountant's views on this matter, see "11 August 2004: SEC Chief Accountant stresses global convergence" at www.iasplus.com/index.htm. As recently as 2001, the European Commission appeared to believe the US would approve IAS within a short period of time. "The Commission hopes and expects that the US Securities and Exchange Commission (SEC) will accept in the near future financial statements prepared by EU issuers without requiring a reconciliation to US GAAP" (Commission 2001).

101 See "Short-term convergence project." www.fasb.org/intl/convergence_iasb.shtml. One important example of a significant US adjustment is FASB's proposal that voluntary changes in accounting policies would be required to be applied by retrospective application rather than by cumulative effect adjustment. See FASB News release 12/15/03. I thank Joel Mathen for his assistance in interpreting the significance of particular accounting measures. Also, FASB has been moving toward more principles-based standards to balance the traditional rules-based approach and the SEC and Congress have encouraged it SEC 2003b. Also see MacDonald 2002 and FASB 2004.

standards setters consider convergence with international standards among criteria used to create new standards.¹⁰² Yet the scandals were more a trigger of change, as the SEC was already by 2000 supporting the IASB in its efforts to improve IAS and encouraging FASB toward working with the international body.¹⁰³

A second set of factors revolve around changes within the IASB itself.¹⁰⁴ These reforms included an organizational overhaul of IASB's predecessor, the International Accounting Standards Committee (IASC), as part of the successful mid-1990s project to improve the quality of IAS and increase the autonomy of IASB.¹⁰⁵ The process did make IAS/IFRS and US GAAP more compatible. In carrying out its improvements project, the IASB deliberately tried to converge IAS with US GAAP where possible. While this made cooperation somewhat easier, it would be wrong to exaggerate the similarities. The two sets of standards remain vastly different and the challenge to converge them is formidable. FASB's most recent study on the differences and similarities between the two sets of standards is a 500-page document.¹⁰⁶ Even if the EU and the US were to accept FASB and IASB as functional equivalents, financial analysts and investors would still need to learn two separate "languages" and implementation and enforcement would remain uneven. The presence of highly regarded international standards and the newly reformed and respected standard setter provided an international alternative to US GAAP and FASB and an obvious necessary condition of the US decisions to engage in the convergence project. But they do not explain why the SEC supported IASC in the first place.

The primary factor behind the US backing of IASC lies largely in the role of EU decisions that subsequently led to a US interest and involvement in IAS. While European policymakers finally passed in July 2002 the regulation mandating that companies listed on EU stock exchanges apply IAS/IFRS by 2005,¹⁰⁷ their influence on US officials started earlier. In 1995, the EU announced its new strategy toward harmonization of accounting standards.¹⁰⁸ Rather than adopt US GAAP or create its own standards, the EU decided to put its weight behind IAS. The move

102 US Sarbanes-Oxley Act of 2002 (Title I, Section 108, b.1.A.v and d.) SEC, 2003 #414. Also see MacDonald 2002; FASB 2004. For a discussion, see Dewing and Russell 2004, 301.

103 SEC 1997; 2003b. Author's interview with SEC staff members, August 17, 2004, Washington, DC.

104 For a chronology of IASC/IASB, see <http://www.iasplus.com/restruct/chrono.htm> and <http://www.iasb.org/about/history.asp>. For histories, see Steinberg, Amer et al. 1999; and Knorr and Ebberts 2001.

105 <http://www.iasb.org/about/structure.asp>.

106 FASB 1999. A summary comparison can be found on <http://www.iasplus.com/usa/ifrsus.htm>.

107 Regulation (EC) No 1606/2002.

108 Commission 1995.

began to alter the prospects for the international standards project in two ways. EU adoption of IAS had the potential to turn the Europeans into the most influential players behind the IASC and create a global rival to US GAAP and the prestige and authority that accompany it. Suddenly, the IASC initiative to improve its standards, originally encouraged by the US via IOSCO, had new meaning and potential. The adoption of IAS in Europe also had the possibility of capturing US firms listing in the EU's fifteen member countries under a single authority. This would give the EU a credible threat to force US companies to provide IAS reconciliation to US GAAP if the SEC refused to offer mutual recognition.¹⁰⁹

By 1999 US SEC Chairman Arthur Levitt was fully involved in the IASB's improvements project. At the time, consensus was building in the EU for the European Commission's ambitious FSAP, which featured harmonization to IAS as a central component.¹¹⁰ In 1998, Belgium, France, Germany and Italy had changed their national laws to permit domestic companies to report in accordance with the international standards and, perhaps most important to the SEC, the UK was a driver behind the renewed integration of European finance. The UK is the primary rival to US dominance in financial regulation. Its turn toward Europe was a blow to Americans who had cultivated the US-British accounting alliance with the hope of re-centring IASC around a core group of like-minded standard setters.¹¹¹ Levitt's involvement in the IASC was in part an attempt to pre-empt the possibility of a rival standards setter with alternative ideas about the future character of international standards. In 2000, the same year that the European Commission proposed complete standardization, not merely harmonization, the SEC issued a concept release asking for comments on the application of IAS in the US.¹¹² In 2001, the SEC Chief Accountant endorsed the global convergence of accounting standards.

The above sequence of events shows how movements toward standardization in the EU transformed the calculations of US regulators even before the formal regulation was passed in 2002. The new regulation not only mandated that all listed

109 This is indeed what the Europeans are doing today. While US officials are insisting on an accommodation for US firms raising capital on exchanges throughout the 25 EU member states, the European Commission and other EU policymakers, flexing their new muscles, have been slow to grandfather in US firms already listed, let alone extend a blanket exemption. Interview with European Commission official, Washington DC, May 5, 2004. Dam and Scott 2004, 4. Author's notes on questions by Michael G. Oxley (Chairman, Committee on Financial Services, US House of Representatives) addressed to Alexander Schaub (Director General, Internal Market, European Commission), Hearings entitled, "US-EU Regulatory Dialogue and Its Future," May 13, 2004, Washington DC.

110 Commission 1998; 1999.

111 The British-US accounting alliance was the foundations of the "Group of 4 + 1" countries—the US, UK, Australia and Canada, plus an IASC representative (Simmons 2001, 611, fn 93).

112 Release Nos. 33-7801, 34-42430; International Series Release No. 1215; File No. S7-04-00 at <http://www.sec.gov/rules/concept/s70400.shtml>.

companies apply IAS/IFRS by 2005 but also set up an elaborate endorsement mechanism designed in part to counter the SEC's influence over the IASCF board members and IASB standard setters.¹¹³ Two months after the regulation's passage, the signing of the Norwalk Agreement illustrated the changed US position.

The key variable behind the altered stance was EU progress toward standardization. It improved Europe's bargaining power vis-à-vis the US, because each perceives the other capable of doing significant harm to its firms. The verdict is still out as to whether the EU's endorsement mechanisms are sufficient for influencing the IASB and overcoming its "Anglo-American" bias in the long run.¹¹⁴ However, perceptions, not reality, of what might emerge in Europe have fuelled the regulatory competition from the start.

VI. Conclusion

The empirical evidence from my five-case comparison, summarized in Tables 3 and 4, offers convincing support for the constructed market hypotheses. I find that previous EU choices concerning integration affect its relative market power in interactions with the US and are important driving forces behind the new symmetry in transatlantic relations in financial services. Variation in the way that the US and the EU manage problems largely reflects differences in the way Europeans integrated a sub-sector.

Can alternative explanations do a better job in accounting for the new balance in transatlantic relations in financial services? None does well against the empirical record. If inherent qualities of particular assets or policy areas are important, they are not the only source of variation as sometimes argued in the functionalist tradition.¹¹⁵ Moreover, contrary to the expectations of Beth Simmons and others who argue that variation in cross-border harmonization of financial regulations depends primarily on US incentives and goals, my evidence highlights EU decisions about European integration.

Explanations from further afield also fail to offer a satisfactory account of the new relationship. Policy makers and analysts often point to the introduction of email, the internet and other electronic communications technologies to explain change in financial markets and regulations.¹¹⁶ The new speed by which transactions

113 van Hulle 2004.

114 Barber 2004; Kerrison 2004; Lex Column 2004; and Norris 2004b.

115 See Aggarwal for an early example. Simmons avoids this trap to some extent by combining functionalist assumptions about the inherent qualities of issue areas with a consideration of relative power (Aggarwal 1985 and Simmons 2001).

116 Interview with senior staff officials of Committee on Financial Services, US House of Representatives, Washington DC, May 6, 2004.

Table 3
Empirical Findings Across Issue Areas

		(t ₂) Management of EU-US Conflicts
(t ₁) EU chooses a principle for integration	Loose Integration	<i>Stock Exchanges:</i> US has not made adjustments. Conflict festers since the mid-1990s. US resists making changes.
	Deep Integration	<p><i>Financial Conglomerates:</i> EU and US make adjustments. US changes domestic rules to meet EU equivalency. EU creates lenient standard for equivalence.</p> <p><i>Public Company Auditors:</i> EU and US make adjustments. US makes exceptions for EU firms. EU passes similar legislation.</p> <p><i>Corporate Board Composition:</i> US adjusts. US reinterprets foreign laws to comply with US rules.</p> <p><i>Accounting Standards:</i> Mutual adjustments in formal negotiations to develop compatible standards. Conflict started in the mid-1990s. Norwalk Agreement of 2002 commits US and EU to good faith negotiations to create compatible standards.</p>

Table 4
Empirical Findings Over Time

Issue Area	(t ₁) Change in EU Approach to Integration?	(t ₂) Change in Management of EU-US Conflicts?
Stock Exchanges	No.	No.
Accounting Standards	Yes, 2002 regulation mandating standardization by 2005.	Yes, mutual adjustments in formal negotiations to develop compatible standards. Conflict started in the mid-1990s. Norwalk Agreement of 2002 commits US and EU to good faith negotiations to create compatible standards.

take place, markets change and new assets are introduced is an important factor behind the increasing number of cross-border conflicts challenging regulators, as incompatibilities between regulations come more readily into sharp relief. Nevertheless, it does not offer an explanation for why the Europeans and American authorities would alter the way they manage conflicts, however often they may arise.

Another alternative explanation highlights a different type of power. The influence of US regulators has never relied on relative market power alone. The attraction of the US model, a form of soft power, has also been an important source of influence.¹¹⁷ Foreign regulators and financiers long considered the US regulatory model as best practice and the most appropriate to emulate. The Enron, Worldcom and other scandals may have chipped away at the attractiveness of the US model to some degree and are a factor in the new transatlantic relationship. Still, the timing of the scandals came too late to have been a cause of the new symmetry.

A final possibility is that frequent consultations, discussions and mutual learning have themselves improved relations and led to a better understanding of one another's positions and cooperative outcomes.¹¹⁸ These types of interactions and outcomes are exactly what I find in the empirical record. But they are an outcome not a cause. The new, more structured interactions, which are central to the ongoing "EU-US Financial Regulatory Dialogue," came about in response to a fundamental change in relative market power. The timing of developments again undermines this argument. The perceived possibility of European retaliation constrained American regulators, under pressure from US firms and EU officials, to be more cooperative. In fact, financial regulators have not been immune to the broader tensions in transatlantic relations. The new pattern of mutual adjustments has occurred despite sometimes tense personal interactions among some of the participants. Even with a better understanding of one another's perspectives, the new "willingness" to compromise on the part of US regulators stems primarily from a fundamental shift in their relative market power vis-à-vis the European counterparts.¹¹⁹

If substantiated with additional evidence, my conclusions about the effects of European institutional reforms would not only add to our understanding of EU-US regulatory relations in financial services and other economic sectors, but also help clarify the EU's impact on global governance and the international economy. In addition, by identifying independent regional effects, my findings demonstrate the benefits of relaxing statist assumptions. National politics and domestic actors are

117 On soft power, see Nye 1990. Also see McNamara 2001 for an example of how sociological factors affect financial and monetary arrangements.

118 Farrell 2003.

119 Interview with former SEC official, Washington DC, May 20, 2004.

not the only components of global political space. The European Union is a deeply institutionalized polity populated with a variety of possible agents of change. Arguably, the current effort to create a regional financial system is the most important contemporary development in global finance. Arguments based on statist assumptions are likely to miss a key causal variable shaping the global regulation of finance.

I end on a paradoxical note. Politicians and regulators on both sides of the Atlantic now recognize that they and their opposites possess the authority to bring great harm to one another's financial services firms. With so much at stake, there is substantial pressure from firms to maintain and enhance current cooperative relations.

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Comments

Sir Nigel Wicks

1. I like Elliot Posner's paper. It deals with issues of global importance. I say that for three reasons—micro-economic, macro-economic and political reasons.
 - It is a truism now in the European Union that integrated financial markets in Europe will enhance prosperity. An efficient transatlantic financial market linking the European and US markets should bring even greater benefits.
 - A stable transatlantic financial market place is a requirement for global financial stability. If a major firm or market either side of the Atlantic runs into trouble, there will be transatlantic and probably global repercussions.
 - Financial markets are—to use Professor Posner's own words—“[...] a critical source of relative national power for achieving international goals.”¹ And “Financial systems help differentiate alternative styles of capitalism.”²
2. So with this much at stake, it is good that those on both sides of the Atlantic with political and regulatory responsibilities for financial services are in regular dialogue.

1 Posner, *supra*, page 238.

2 *Id.*, page 236.

3. As I understand it, the objective of this dialogue is limited, but realistic. It is not to “integrate” the two markets, in the way that the European Union member states are seeking to integrate—that is make one—their financial markets.
4. Such an objective—the creation of an integrated transatlantic financial market—is, and I believe forever will be, constitutionally and politically unrealistic. The purpose of the current dialogue is more realistic. It seeks to create a state of peaceful coexistence between the two markets so as to permit market participants on either side of the Atlantic, who are often the same firms, to penetrate each other’s markets with the minimum of frictions and barriers.
5. Professor Posner’s paper raises the interesting question why did the dialogue start when it did—around 2002. The three issues—micro-economic, macro-economic and political—are certainly not new. They were around for a good part of the nineties. So what was new in 2002? What was it that caused the more balanced strategic interaction?³ Or to put it the point more plainly: why did the US financial authorities start to treat seriously with the European authorities?
6. After all, the wider climate for transatlantic co-operation in the early twenty first century was not propitious. Moreover, the US official economic establishment, be it in the legislative, executive or central banking branches, has sometimes been reluctant to give credence to EU financial ambitions.
7. I find the paper’s explanation in its “constructed market power hypothesis”⁴ reasonably compelling—that the “EU-US Financial Regulatory Dialogue” came about in response to a fundamental change in relative market power.⁵ And that change—again to put it in plain terms—was because, after years of high flown rhetoric, there was credible evidence that the EU was at last getting its act in order in creating an integrated market in financial services. That evidence was the creation of the Euro, the steady enactment of the FSAP and the agreement to the streamlined legislative process recommended by the Lamfalussy Committee.
8. As an explanation, that certainly rings true. Market power recognises market power, even when the EU power is, in this case to a large extent embryonic, rather than actual.

3 *Id.*, page 246.

4 *Id.*, page 235.

5 *Id.*, page 261.

9. But I would take the argument one step further and ask, "What, or rather who, was it that prompted this recognition?"
10. I believe that the real movers and shakers behind the establishment of the Transatlantic Financial Dialogue are the US securities houses, the broker dealer community, and all credit to them for it. The Securities Industry Association's International Committee wrote to US Treasury Under Secretary John Taylor as long ago as December 2001 supporting the creation of a new US-EU financial markets dialogue saying: "The extensive capital markets linkages that have developed between the US and EU make it all the more important that a more formal dialogue be established to supplement the ad hoc contacts that have existed and sufficed up till now."⁶
11. By the beginning of the twenty first century, this community was making significant profits in Europe, mainly, but not entirely, through their London offices. For example, the US Securities Industry Association's "[...] largest members engaging in global business receive about 20 percent of their net revenues (excluding interest) from European markets."⁷
12. That community was well attuned too to the developing political realities within the European Union. The expertise in lobbying garnered over long years on Capitol Hill had been transplanted into the corridors of Brussels and Strasbourg. I can testify from my membership of the Lamfalussy Committee that the evidence of the American Chamber of Commerce in the EU was among the most cogent and forward looking.
13. My hypothesis, which is consistent with Professor Posner's, is that the broker dealer community sensed which way the wind was blowing, mobilised their forces in Washington to begin to engage with the Europeans and the New Transatlantic Relations in Financial Services was the result.
14. Of course, the US industry's stance did not arise out of pure altruism. It suited their business interests, though it is worth emphasising that the motivation was not old-fashioned trade protectionism. In fact, the reverse was true. The US industry was motivated by the wish to support the creation of the European Single Market in financial services and to avoid, in their transatlantic business, the frictions, tit for tatting and reciprocity games that are so redolent of trade negotiations.

6 Testimony of Chairman of the Securities Industry Association before the House Financial Services Committee on Domestic and International Monetary Policy, June 17 2004, page 14.

7 Ibid., page 4.

15. It should not be surprising if the US financial houses active in Europe acted in the way that I suggested.
16. They act on a pan-European basis and take a pan-European view. Most American investment banks, broker dealers and global custodians have offices in London, Paris, Frankfurt, and Milan and often in Madrid, Amsterdam, Luxembourg and Stockholm and in other capitals too.
17. Very few indigenous European financial houses have such a pan-European coverage.
18. This makes the American financial community best placed among the entire financial community active in Europe to benefit from the creation of the Europe Single Market in Financial Services. It is not therefore surprising that the Securities Industry Association is such a strong supporter of the Financial Services Action Plan.
19. That is not a reality to regret or to fight. It is a force to harness in the interests of creating a competitive European economy and competitive financial institutions in Europe.
20. The motives of the EU side in espousing the dialogue are somewhat easier to divine. Prior to 2002, there had been spasmodic contacts between a few of the member states and the US authorities, but nothing on a regular or organised basis. The same was true too for Commission-US contacts. It was hardly surprising that the Commission welcomed the opportunity for more regular dialogue with the US authorities. Understandably enough from their Treaty mandate, the Commission are always ready to take up opportunities to represent the EU in international forums. Rivalries within the Commission between the Financial Markets and Trade Directorates may also have played a part here. If the Financial Markets Directorate had not taken the lead, the Trade Directorate may well have sought to divert the transatlantic financial dialogue into trade channels. If that route had been chosen, the subsequent story may have been rather different.
21. Professor Posner goes on to argue that the empirical findings from his five case studies demonstrate support for the constructed market hypothesis and that "[...] EU choices concerning integration affect its relative market power in strategic interactions with the US and are the primary driving forces behind the new symmetry in transatlantic relations in financial services."⁸ The harmonisation route, he argues, elicits a more forthcoming response from the US authorities than mutual recognition. The argument here is that the concentration in the Commission of powers implicit in the harmonisation route make the Commission more likely to win concessions

8 Posner, *supra*, page 259.

from the US side than the mutual recognition route, where power is dispersed to the member states.

22. If this is the conclusion, I suspect that the US financial community may not much relish it. They normally have a preference for the mutual recognition route, not much relishing what can sometimes be a one sized fits all harmonisation route.
23. Three further thoughts stimulated by the paper.
24. First, the current dialogue is institutionally asymmetric. What I mean by that is that the participants on each side, inevitably, have different constitutional statuses. The main protagonists on the EU side are the Commission; on the US side, there is the US Treasury, who lead, supported by the Fed and the SEC. There have been spasmodic contacts between the respective Committees in the European Parliament and the House of Representatives. Representatives of the member states are conspicuous by their absence. This institutional asymmetry is highlighted by the fact that all three representatives on the US side go to the Financial Stability Forum, which brings together the regulators from eleven countries with financial centres, yet the Commission are not members though the European Central Bank does attend.
25. Second point, the political accountability of the process, at least on the EU side, is a bit obscure. The Commission does make reports to the Council from time to time, but these are, I understand, brief and anodyne. Very little is made public. Member states and national legislators are not much involved.
26. Third point, the private sector, market participants on both sides of the Atlantic, are not much involved.
27. It is unclear whether these three points, the asymmetric institutional representation and the lack of political accountability and private sector involvement, matter. The process is intended to be low key, informal and non-political. It appears to be working. So if it ain't broke...

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Chapter 10

Calming the Waters: The Rebirth of the Transatlantic Business Dialogue

Maria Green Cowles

I. Introduction

Since its inception in 1995, the Transatlantic Business Dialogue (TABD) has served as an important symbol of the transatlantic economic relationship.¹ To American and European Union governments, the TABD represents an important partnership that informs government decisions on transatlantic and global trade and regulatory matters. To many in the non-governmental organization (NGO) community, the TABD is focused on advising governments on how to remove “important worker, consumer and environmental laws and regulations which it views as ‘barriers to trade,’ and which everyone else views as measures that save lives, keep our air and water clean, and protect endangered animals and plants” (Public Citizen 2004). To those less charitable, the TABD symbolizes business-government conspiracy theory at its best (Mokhiber and Weissman 2000).

To many, the TABD is also a bellwether of the health of the transatlantic economic relationship. During its early years, the TABD’s success was largely mirrored in the broader US-EU political relationship, despite the two entities’ World Trade Organization (WTO) rows over bananas and beef hormones. By the

¹ I thank the many business and government officials who granted me interviews for this project. I also thank Jessica Gilroy for her work on this research, and Wakenda Tremmel for her editorial assistance.

end of 1999, the TABD was losing its direction with an American president whose attention to transatlantic affairs was shortened by impeachment proceedings, and with a new administration coming to power whose views on US-EU relations were unknown. The arrival of the George W. Bush administration in 2000 brought new uncertainty to both the future of the US-EU relationship and the TABD. While the 11 September 2001, terrorist attacks shocked both sides of the Atlantic, “the events of September and afterwards marked a dramatic and abrupt change in the balance of leadership [between the US and EU]...” not only in the war against terrorism, but also in trade negotiations, international monetary policy, and “the whole business of global order and governance” (Allen and Smith 2002, 112). Indeed, transatlantic debates over Saddam Hussein’s weapons of mass destruction and the Bush Administration’s entrée into the Iraq war appeared to sound a death knell for the TABD. The same year, one of TABD’s biggest critics, the Corporate Europe Observer, proclaimed that the TABD was in “troubled water” (CEO 2001). In 2002, the group went further to question whether the TABD was a “sinking ship” in “stormy waters” (CEO 2002).

Less than two years later, however, the European Commission Enterprise and Industry Directorate General would contradict the TABD’s demise with its own headline, “Business Bridges Transcend Troubled Waters” (European Commission 2004). TABD business leaders met directly with President Bush, Bertie Ahern (President of the EU Council and Taoiseach of Ireland), and Romano Prodi (President of the European Commission), to present their recommendations at the US-EU Summit in Ireland. As one official who has worked closely with the TABD for many years acknowledges, “2004 has been one of the most successful years for TABD.”²

One might argue that the TABD’s rebirth can be directly linked to the improved climate between US and EU political leaders. Indeed, considerable effort has been made on both sides of the Atlantic to avoid rhetoric such as Robert Kagan’s oft-cited phrase that “Americans are from Mars and Europeans are from Venus: They agree on little and understand one another less and less” (Kagan 2003). Moreover, as evidenced by the results of the June 2004 US-EU summit, the United States and Europe—while in retrospect not sharing a political consensus about Iraq—now share a broader political consensus (though not without dissension) on the way forward in Iraq and the Broader Middle East. However, to suggest that the TABD re-emerged due to the improved US-EU political-military climate would be misleading. Indeed, as argued in this chapter, TABD’s revival can be directly linked to a time period when the US-EU political environment, according to some commentators, was arguably worse than at any other point since the Second World War (Schweiss 2003, 1). Business leaders on both sides of the Atlantic publicly

2 Correspondence, December 5, 2004.

called on government leaders not to lose sight of the US-EU important relationship, economic and otherwise. At the same time, key EU, Member State, and US government officials began to regard the TABD as a vehicle to promote dialogue between the two sides—to promote “practical plans” that could divert the attention of officials who were otherwise focused on ideological divides. At the 2002 Chicago TABD conference, EU Trade Commissioner Pascal Lamy noted,

[...] We desperately need the stabilising role that transatlantic business has on the overall EU-US relations... By your [TABD] actions, you never fail to remind us of the level of EU-US interdependence, and of how much we rely on business to drive forward economic growth (Lamy 2002).

A number of European leaders including Spanish President José Maria Aznar and British Chancellor of the Exchequer Gordon Brown publicly called for reinvigorating the TABD (“Brown,” 2003). Within the US administration, Grant Aldonas, the Under Secretary of Commerce for International Trade, also saw the need to create some form of economic counterweight to the political differences in the relationship. In his discussions with Commerce Secretary Don Evans, Aldonas advanced the TABD as an important means to reengage transatlantic dialogue and to promote the US-EU economic relationship as the “ballast in a relationship where this is always going to be some amount of political friction” (US Mission 2003).

Today, the TABD has re-emerged as an important means—among other factors—to help right the US-EU ship and to guide the transatlantic economic relationship into calmer waters. The purpose of this chapter is to examine the TABD’s future role in the health and direction of this relationship. The chapter begins by identifying key developments in the TABD’s rise and decline. The following section assesses the strengths and weaknesses of this public-private partnership, including the diverging institutional regulatory frameworks under which the US and EU operate. The latter part of the chapter analyzes the rebirth of the TABD and its new and arguably dramatic goal: the creation of a barrier-free transatlantic marketplace. I conclude that the TABD’s success in achieving this goal will rely less on the firms’ guidance, and more on the governments’ willingness and ability to address key domestic institutional impediments to transatlantic economic governance.

II. Origins, Success and Demise

Over the years, the TABD has defined itself in a variety of ways. Early on, the TABD referred to itself as an entity—a business-to-business dialogue on US-EU economic and regulatory issues. Over time, however, TABD officials repeatedly referred to the TABD “process”—the means by which US and EU governments and businesses address these issues. In 2004, the TABD has redefined itself as “an

effective framework for enhanced cooperation between the transatlantic business community and the governments of the European Union and United States" (TABD 2004b). The current TABD definition more closely reflects what I have defined in academic terms as a "public-private partnership" in transatlantic economic policymaking (Cowles 2004).

Despite its name, the Transatlantic Business Dialogue (TABD) has always included an important government dimension. The idea for the TABD, in fact, did not originate with the business community, but with the late US Commerce Department Secretary Ron Brown.³ Brown believed that international companies were at least five years ahead of governments in their thinking about trade liberalization, and thus better positioned to inform transatlantic policy goals. Brown envisioned a process in which the Chief Executive Officers (CEOs) of leading US and EU companies would identify key issues and bring them directly to government leaders. The Commerce Secretary reasoned that the CEOs would bring the visibility and political impetus necessary for government leaders to respond—particularly European Commission officials whom Brown believed were too removed from business interests.

While some in the European Commission were initially sceptical, key European Commission officials soon supported Brown's initiative. Sir Leon Brittan, the EU Commissioner responsible for US-EU relations, welcomed a process that could bring greater trade liberalization. EU Industry Commissioner Martin Bangemann, a strong supporter of European business, also supported the initiative. Of course, both men were receptive to a process that would give the Commission greater visibility vis-à-vis major firms in an area where member states continued to exert considerable influence.

In April 1995, Brown, Brittan, and Bangemann sent letters to 1,800 US and EU industry officials asking for their input on a trade liberalization agenda. The business community's response surprised the government leaders and perhaps confirmed Brown's own thinking on the disconnect between government and business perceptions on market issues. The companies argued that the elimination of transatlantic tariffs was not a top priority for companies operating in both the United States and Europe. Instead, the companies pointed out that duplicate standards, testing, and certification procedures were far more arduous and expensive for firms engaged in transatlantic business. Put another way, for global companies with considerable foreign investment in the transatlantic marketplace, it was not the "border issues" (i.e. tariffs) that were of concern, but the "behind the border" regulatory issues.

3 For an extensive history on the early years of the TABD, see Cowles (2001).

The TABD was launched in July 1995 when a joint US-EU steering committee comprised of government and industry officials met to discuss business concerns. Four transatlantic working groups were created to develop papers in the following areas: 1) standards, testing/certification, and regulatory issues; 2) trade liberalization, 3) investment, and 4) third country relations. The group decided to hold a conference in Seville, Spain, in December 1995 that would bring together the CEOs and high level government officials to discuss recommendations in these four areas. The goal was to formally offer the Seville recommendations to government leaders at the US-EU summit the following month.

The period leading to the Seville conference proved challenging as the two sides began to identify problem areas and to discuss divergent regulatory systems. Considerable discussion and "confidence building" took place as participants pointed to market and regulatory impediments on both sides of the Atlantic. Despite early tensions, the Seville conference proved successful as the US and EU CEOs and government leaders sat down to constructively discuss a myriad of issues. The "spirit of Seville," as it became known, resulted in over 70 recommendations presented to the two governments, many of which were later incorporated in the New Transatlantic Agenda (NTA) the following month. The NTA, which ushered in a new format for US-EU government relations, made special reference to the business group's activities:

We will not be able to achieve these ambitious goals without the backing of our respective business communities. We will support, and encourage the development of, the transatlantic business relationship, as an integral part of our wider efforts to strengthen our bilateral dialogue. The successful conference of EU and US business leaders which took place in Seville on 10/11 November 1995 was an important step in this direction. A number of its recommendations have already been incorporated into our Action Plan and we will consider concrete follow-up to others (NTA 1995, title IV).

The TABD engendered a novel form of policymaking process in the transatlantic partnership. Whereas historic negotiations over trade matters were combative and defensive, the TABD brought a new tenor to the negotiations. Participants had come to recognize that "they needed to develop very deep interrelations between two big systems [...]. The TABD was a paradigm for how this kind of exchange could take place" (Cowles 2001: 264-265).

A. Transatlantic Economic Governance in Practice

The early years of the TABD were characterized by institutional adaptation and policy learning as new business-government relations were forged and the various participants learned to work with one another. The TABD CEOs and business representatives were also interested in results. In the early years, the two sides

experienced a number of success stories. In 1996, despite a US-EU political climate tainted by disagreement over the Helms-Burton legislation on Cuban investment, the Chicago TABD conference heralded several important breakthroughs including an agreement on the Information Technology Agreement and the conclusion of several Mutual Recognition Agreements (MRAs) covering over \$40 billion of transatlantic trade a year. Several of the MRAs, for example, laid out agreements for US and EU testing facilities to recognize each others' standards over time, thus allowing firms to have their products tested once on either side of the Atlantic before coming to market. (See Table 1.)

Table 1
Summary of TABD Highlights

Year	Conference	Outcome Highlights
1995	Seville	NTA recommendations
1996	Chicago	Information Technology Agreement, Mutual Recognition Agreements (MRAs)
1997	Rome	Preventing "protectionist" legislation in areas such as labeling and electronic commerce
1998	Charlotte	TABD scorecards
1999	Berlin	Early Warning System, WTO
2000	Cincinnati	Guidelines on Regulatory Cooperation and Transparency

In 1997, the TABD continued to identify regulatory problems and succeeded in delaying what the companies viewed as protectionist legislation in labelling and electronic commerce at the TABD Rome conference in November. The TABD's "success" also became wider known through the companies' efforts to inform Congressional and member state leaders of their agenda. Testifying before a Congressional committee in 1997, Undersecretary of Commerce Timothy Hauser noted "it is difficult to overstate the effect the TABD has had on trade liberalization... Virtually every market-opening move undertaken by the United States and the EU in the last couple years has been suggested by the TABD" (quoted in Mokhiber and Weissman 2000).

By 1998, the TABD's achievements in proposing transatlantic regulatory reform ironically led to disappointment within the organization. CEOs and corporate chairmen quietly expressed frustration with governments for failing to implement TABD recommendations in a timely manner. The business leaders developed a

TABD "scorecard" to publicly rate government activity on various initiatives. Government officials, for their part, expressed annoyance at the business community's naiveté both in assuming that most TABD recommendations would be implemented and in not recognizing the considerable bureaucratic, and in some cases, new legislative and administrative measures that were needed for other regulatory changes to take place.

The TABD's relative success also created an unwanted bandwagon effect as more companies became involved in the process. The 1998 Charlotte TABD conference featured more than 500 business and government officials, compared to 300 two years earlier. With more individuals demanding podium time, the more intimate discussions between CEOs and high-level government figures on transatlantic regulatory issues began to disappear.

In 1999, the TABD saw the creation of more working groups that focused on everything from fasteners to cosmetics. The TABD conference in Berlin attracted over 700 participants and resulted in a dense 65-page report. The business leaders' primary touted success was the incorporation of an "Early Warning System" through which US and EU governments would alert one another to potential regulatory conflicts before they transformed into significant transatlantic disputes. TABD CEOs also sought to solidify the transatlantic position on several WTO matters pending the ministerial the following month with government leaders. The triumph of anti-globalization protest groups in shutting down the Seattle WTO ministerial, of course, largely negated any TABD positions at the time.

The following year, the TABD business leaders attempted to reinvigorate the TABD process by promoting "Guidelines on Regulatory Co-operation and Transparency" that would encourage greater cooperation on TABD issues. The 2000 TABD Conference in Cincinnati attracted several hundred protesters who spoke out against "corporate globalization." The irony was that as the public spotlight grew on the TABD's purported secret "deregulatory plots" and other "scheming" (Mokhiber and Weissman 2000), TABD officials were questioning its very future. The conference was marred not so much by the protestors and newspaper headlines as by the new US administration's relatively tepid show of support at the event.

The TABD's demise appeared cemented over the next two years. In the aftermath of 11 September, the TABD cancelled its 2001 scheduled conference in Stockholm and held a teleconference meeting instead with a small group of high-level business and government officials. The meeting resulted in general agreement to move ahead on the "Guidelines on Regulatory Co-operation and Transparency." In yet another effort to revive the group, the TABD was reorganized again in 2002. Its efforts at the second Chicago conference, however, were largely focused on damage control. One TABD person was designated to work full-time with media to answer questions not only about TABD proposals, but more often about crowd

control. The Chicago police force dedicated upward of 1,000 officers and shut down eight city blocks for five days. While the TABD produced an unwieldy 52-page report, the TABD conference could count barely 70 high level business leaders in attendance. As one individual close to the TABD noted, the organization was soon on “life support.”⁴

In 2003, efforts began anew to resuscitate the TABD. EU Commissioners Pascal Lamy and Erkki Liikanen continued to speak out in favour of the TABD process. Yet, the TABD’s success was not eminent. In the words of one commentator “It all looks like a desperate effort to revive the embers of a dying fire” (“Europe” 2003).

But the TABD did not die out. Instead it re-emerged with the support of both governments and a forceful new goal of creating a barrier-free transatlantic marketplace. TABD’s importance to the transatlantic economic relationship can be seen in why and how it was revived. Whether or not it will be successful in transatlantic economic governance will depend in part on the extent to which its strengths and weaknesses are addressed.

III. Strengths and Weaknesses

The TABD model of structured interaction between CEOs and high-level government officials is now recognized and emulated by various groups involved in European and American international trade and regulatory issues. Yet over the years, various TABD chairmen have attempted to restructure this model. They have wrestled with ways to engage the governments and to keep them on track to implement TABD companies’ proposals. These reorganizations—including the efforts in 2003–4—can only transform TABD to a certain degree.

There are four key factors that have defined the TABD and that speak to both the strengths and weaknesses of this public-private partnership. The first two—the TABD’s political nature and institutional framework—are inherent to the organization. Past reorganizations largely have failed to address these political and institutional dynamics. The second two factors—the TABD’s practical strategy and conference format—are procedural and more malleable. As I argue in the last section of this chapter, an awareness of these factors is important for understanding the TABD’s demise and rise, and critical to assessing its future in transatlantic economic governance.

A. *The Political Nature and Political/Economic Cycles*

As highlighted in Figure 1 below, the TABD is a public-private partnership. This means that for the TABD to be effective, three different relationships matter: the

4 Interview, February 5, 2004.

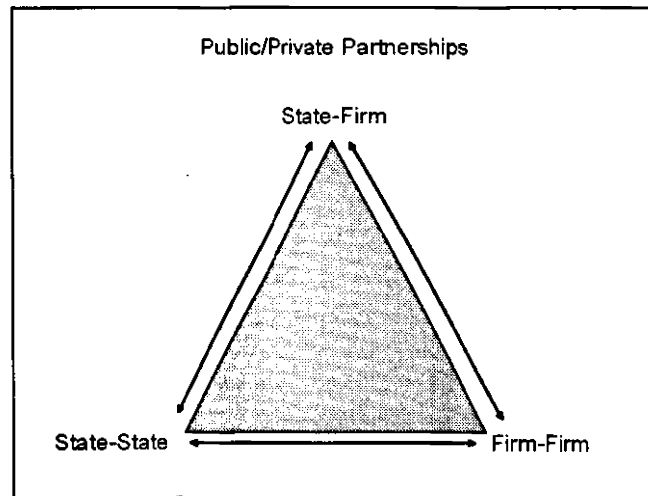
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business-to-business dialogue, the government-to-government dialogue, and the business-to-government dialogue. It is thus inherently political in nature.

The TABD's strength lies in the dynamic interaction of these dialogues. Positive interaction in one dialogue can enhance the interaction in another dialogue. Technical details and regulatory minutiae aside, the TABD is effective precisely because high-level government officials—Commissioners and to a lesser extent member state leaders in the EU, and presidents and political appointees in the United States—are committed to the process, and because CEOs become personally vested in transatlantic economic cooperation.

Of course, an inherent weakness is that the breakdown of one relationship—for example, the government-to-government dialogue—ultimately influences the ability of the partnership as a whole to operate. In the case of the TABD, there are inherent political cycles that impinge on these relationships. When President Bush took office after President Clinton in January 2001, the future of the TABD was uncertain. Similarly, the transition to the new European Commission in 2004 also posed challenges to the partnership, as did the views of newly admitted Eastern European countries that had little or no experience with the TABD process. In 2005, the departure of Commerce Secretary Evans and the arrival of his replacement will also alter the relationship.

Figure 1
The TABD as a Public-Private Partnership



Source: Adapted from Cowles 2003

Business cycles also impact the dialogue. CEOs step down from their office when the companies are not performing as well as the Board of Directors and/or shareholders deem appropriate. TABD organizers often joke about the “curse” of the TABD chair persons—many of whom have been required to relinquish their one-year TABD positions when forced to resign from office or announce their early retirement. In addition, poor economic conditions often require CEOs to stay in the office and not to be in the headlines for their TABD work. The fact that many TABD issues are broader in nature and only tangentially related to a company’s bottom line will also impact a CEO’s decision to participate.

B. The Institutional Framework and “Political Will”

As noted above, one of the great strengths of the TABD over the years has been the role of the US-EU government officials in shaping the dialogue, attending conferences, and commenting on drafts. Government leaders were instrumental in creating the dialogue in 1994, and in relaunching it almost a decade later. Government officials have also been somewhat successful in organizing themselves for the TABD process. The European Commission, for example, developed a contact list to clarify the points of contact for various government activities. The Commerce Department has sought to bring together officials from various regulatory agencies to facilitate discussions on regulatory issues.

Despite these efforts over the years, business leaders have often criticized government leaders for not having the “political will” to address and implement key business proposals. TABD scorecards and progress reports were initiated to encourage governments to find the means to bring about these changes. The problem with this approach is that business has often mistaken “lack of political will” with the inherent rules and institutional frameworks on each side of the Atlantic. For example, TABD issues that arose in the aftermath of 11 September highlighted the institutional issue of EU “competency.” While the EU has taken tremendous strides in addressing internal security issues under the direction of former Commissioner Vittorino, it is not clear how a TABD homeland security taskforce would neatly separate issues dealing with “security” (still a member state competency) and trade (the European Commission). For their part, Commission officials are quick to point out that the US also must address “mixed competences” between the federal government and the 50 states.⁵ Services regulations, for example, often reside in part with the states—whether they are mundane issues like elevator operations or headline stories like financial services.

Even more critical to the TABD is the extent to which regulatory rules and institutions are set up on both sides of the Atlantic to address the “deeper

⁵ Interview, March 11, 2004.

transatlantic integration” championed in TABD. Because TABD focuses on “behind-the-border issues,” it inherently addresses the convergence of domestic regulatory rule-making. While American companies may complain that the European Commission fails to adequately heed the advice of transatlantic business (a point at odds with the NGO perception of TABD Commission-business relations), the EU’s institutional framework is rather adept in implementing TABD regulatory change—and is an important strength to the TABD. One key reason for this is because the EU already has the institutional framework to allow for “re-regulation” under the Single Market. As Majone has pointed out, the EU was designed in part as a “regulatory state” (Majone 1996). In most instances, TABD proposals do not entail any additional institutional changes to EU regulatory policy-making. On the contrary, while the Commerce Department may tout itself as a champion of transatlantic business concerns and promoter of US business interests, neither it nor the United States Trade Representative has the authority to overhaul domestic regulatory policymaking. While Commerce officials may bring the heads of US regulatory agencies to the negotiating table, the regulatory agencies are neither funded nor mandated to undertake the supranational regulatory coordination called for in TABD. In short, political will alone cannot bring about change in regulatory mandates. Rather, executive and legislative leaders must dedicate considerable effort and capital to reform—or more appropriate, transform—long-established domestic regulatory rule-making and to develop the mechanisms necessary to engage in significant transatlantic and global regulatory policymaking.

C. The Strategy: Practical and/or Grand?

The focus of the TABD agenda has changed often since 1995 with different priority areas and different working groups. Indeed, each successive TABD business leadership team has attempted to improve the process and redefine or streamline committee structures. A deliberate strategy, formally known early on as the “building block” approach, remained largely untouched.

Since its inception, the TABD did not attempt to develop a major project such as a US-EU Free Trade Agreement, but rather to make small integrative steps that would build on one another. Coupled with this is what TABD officials have termed a positive “bottom-up approach” to US-EU trade relations—developing practical, results-oriented proposals among business and pushing them up through the government—in contrast to the traditional “top-down” mandate of government actors. Indeed, the TABD business groups have been hesitant to embrace “top-down” initiatives such as Sir Leon Brittan’s proposal for a New Transatlantic Marketplace (NTM) in March 1998. In the early years of the TABD, companies raised concerns that such initiatives might detract from the day-to-day progress achieved in the TABD, or that such an approach might result in a large “package deal” that would make successful negotiation all the more difficult. In general,

TABD companies who had experienced bruising battles in various WTO arenas were wary to commit the time, money, and capital necessary to promote such an initiative given the demands of their overall public affairs activities.

The TABD's "practical approach" has been an important strength to the process. When US and EU government officials were exchanging words over the Helms-Burton legislation in the late 1990s, the TABD provided a non-contentious means to bring the two parties back to the table. By focusing on practical matters, governments were able to refocus on the transatlantic economic relationship. As discussed below, the TABD's practical orientation also provided a critical focal point when US and EU officials became immersed in more political, ideological battles. Indeed, the TABD's "practical" strength became a key reason why government officials wanted to resurrect the organization in 2003-4. As more than one official noted at the time, if the TABD did not exist, the governments would have to create it.

Yet, there was an important weakness to the TABD's practical focus—at least in the bottom-up building blocks approach. As Michael Smith points out, the TABD's building blocks approach lacked a "grand strategy"—an overall plan to address the growing interdependence of the two markets in the face of divergent regulatory structures and industrial cultures (Smith 2001). There was no defined endpoint or recognition of how to achieve such an endpoint. This meant to some companies and government leaders that the organization's purpose was difficult to discern.

D. The TABD Conference: Building Support and Legitimacy

Over the years, the annual conference became a TABD hallmark. Beginning with the 1994 Seville conference, the TABD's timetable was driven by this annual event. The conference served as an action-forcing event requiring companies to come to agreement on core issues and governments to provide the "deliverables." The meeting provided the means to remind governments of the urgency of certain recommendations.

In supporting the TABD, government officials and company representatives cite the drawn-out and technical negotiations that occurred in past US-EU trade and regulatory negotiations. Industry recommendations from national industry association became lowest-common-denominator responses that were of little value or interest to policymakers. The TABD CEO-led format, on the other hand, brought a political dynamism to the process and the major players to the table at the annual conference. Secretaries of Commerce, Commissioners of industry, heads of independent regulatory agencies were willing and interested to sit down with the titans of industry. CEOs, for their part, did not want to focus on the technical minutiae, but promoted broader initiatives that governments could embrace and undertake. The conference, in effect, became the arena around which the TABD business-government relationship was defined.

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The TABD conference also became an important means to help legitimize TABD proposals by opening up the dialogue to other transatlantic business communities and government constituencies. Key representatives from small- and medium-sized companies were given prominent roles at the event. Outreach meetings to various business groups took place before and after the conference. Working group recommendations were highlighted in the conference report. Member state representatives, regulatory agency officials, and trade association presidents were invited to the annual conference.

Yet, the TABD conference also had its weaknesses. First, bringing CEOs to the TABD conference was not always easy. CEOs needed to justify to their shareholders that participating in the TABD conference and devoting oneself to TABD issues would make economic sense for the company. Much of the TABD administrative work over the years simply was ensuring that the CEOs show up at the conference. This was especially difficult once companies began experiencing economic downturns around 2000-1. Second, despite the efforts of organizers, the TABD focus on regulatory issues often resulted in looking at the very technical minutiae that TABD creators initially disdained. Thus, CEOs often showed up at the annual meetings with briefing books in hand to discuss nitty-gritty details that usually were reserved for the company lobbyists. High-level government officials likewise needed to be extensively briefed in order to participate in these discussions. CEOs again began to question whether the annual conference was worth their effort, and/or whether their meetings with senior governments officials could have been better spent on other matters.

Time revealed another weakness of the conference when it became "too defining" an event. TABD coordinators found themselves spending an inordinate amount of time on conference details. During TABD's early years, they had to address unwieldy numbers of participants, such as the 700-plus individuals who attended the Berlin conference in 1999. During the later years, they focused on simply getting a large enough number of prominent CEOs to attend. Then they worked to accommodate the egos of high-level officials who wanted to give speeches and/or wanted to receive the proper seating arrangement in comparison to his/her European/American counterpart.

Perhaps more importantly, the conference began to represent the life or death of the TABD. The TABD agenda was drawn up around the conference schedule and if the proper results were not achieved and/or if not enough CEOs appeared at the conference, the TABD itself was deemed a failure. In many respects, the conference overshadowed all the positive work of the TABD partners throughout the year.

By the late 1990s, the role of the TABD conference as a means to open up and legitimize TABD actions to a larger business-government community also was under attack. The TABD conference became a focal point for protestors who disagreed with the government-business initiative, and/or who disagreed with the

purported power of major multinational corporations involved in the public-private partnership. TABD organizers soon found themselves paying significant attention to conference security details so as to permit business and government officials to convene, while allowing protestors to express their views outside the conference meeting place. As discussed below, while protestors were criticizing the “behind-the-scenes” meeting between government and “big business,” their actions were sowing the seeds for TABD to be less visible in the future.

As discussed below, these strengths and weaknesses came to the fore in 2001-2 and ironically led to both the fall and rebirth of TABD in 2003-4. They will also matter in the future US-EU economic relationship.

IV. The War in Iraq and the Relaunch of the TABD

Government and industry officials cite a number of factors leading to the general decline of the TABD—many of which can be linked to the strengths and weaknesses identified above.⁶ To begin, the TABD was in a sense a victim of its own success. The bottom-up approach produced a number of important breakthroughs. However, the TABD agenda soon became cluttered with too many regulatory issues on the table and no clear sense of the business community’s priorities on the issues. The process became unmanageable as governments became inundated with the laundry list of items, and business became disappointed with the slow pace of policy implementation.

Complicating this situation was the fact that the TABD focused on the “low-lying fruit” in the early years—on the non-contentious issues that were “doable” for governments. As the companies turned to regulatory issues involving deeper integration, they encountered a number of obstacles, notably with US regulatory agencies. This led to frustration on the CEOs’ part about the lack of government “political will.” Yet, as noted above, it was not a lack of government advocacy per se that left the companies dissatisfied. It was the perceived inability to effectuate change vis-à-vis government institutions, notably US regulatory agencies, that proved frustrating.

Yet another factor that led to the TABD’s decline was the political cycles and the subsequent lack of attention to the transatlantic agenda. In the US, the Clinton impeachment process soon consumed the administration and left the TABD, among other policies, on the fringes. The arrival of the George Bush administration in 2000 severely tested the dialogue. The Commerce Department under Secretary Don Evans was rather reluctant to pick up on an initiative that had been a “Brown project” and “Clinton administration initiative.” The Bush administration also

6 This section benefited from joint research with Jessica Gilroy. See also Cowles and Gilroy (2004).

believed that given its good relations with the business community, “the Republicans didn’t need the TABD” the way that Democrats did.⁷ The US government’s reticence was not lost on the business community and the European Commission which became reluctant to use its political chips on the TABD.⁸

A. 11 September 2001

The new Bush administration tested the TABD in non-economic ways as well. The larger transatlantic political relationship experienced setbacks when the US administration began to distance itself from multilateral negotiations such as the Kyoto Protocol and International Criminal Court. Concerns over diverging viewpoints on the Middle East peace process further contributed to the US-EU tensions. Confounding the situation was a worsening world economy and the failure to restart WTO actions at the Doha and Cancun meetings. 11 September 2001, however, proved to be the defining factor in testing not only the broader US-EU relationship, but also the TABD itself.

The 11 September attacks in the United States immediately stopped the transatlantic squabbling as European leaders expressed solidarity with the United States, even invoking Article 5 of the North Atlantic Treaty. In time, however, the attacks also contributed to further divisions within the relationship as the Bush Administration radically shifted its focus toward national security matters. The political rhetoric and policy shift that followed the 9/11 attacks proved most difficult for the TABD. The administration’s stance, in which the president argued that countries were either for or against the United States in its fight against terrorism, resulted in three outcomes for the TABD. First, the new political/military focus immediately overshadowed the TABD, along with many other initiatives. Second, the organization was put on “life support” as transatlantic political tensions grew. With the US and EU exchanging caustic remarks with one another, and the EU Member States finding themselves divided over Iraq, there was little room for dialogue on economic matters. Third, and somewhat ironically, the new political/military dynamics planted the seeds for the TABD’s relaunch.

Before the TABD could emerge again as an important focal point in US-EU relations, however, it would undergo its own near-death experience. The cancellation of the 2001 TABD conference in Stockholm, Sweden, and its replacement with a videoconference—hampered by technical glitches and voice delays—denied the TABD one of its defining features. Without a conference, there was little momentum to move forward the following year. In January 2002, the EU announced that John Weston of BAE Systems would be the new European TABD

7 Interview, February 5, 2004.

8 Interview, March 4, 2004.

co-chair. For the next several months, however, no American CEO could be found to lead the American side until Phil Condit of Boeing Corporation was recruited in late March. The quarterly profit reports that influence business cycles and determine the tenure of chief executive officers quickly dashed glowing TABD announcements of the new leadership team. Days after Condit's role was revealed, the BAE Systems board announced the firing of Weston. TABD officials were relieved when Mike Turner, Weston's replacement, declared that he would serve as TABD co-chair.

Critics of TABD quickly pointed out the "militarization" of the organization. With BAE Systems as "the world's largest weapons producer" and Boeing Corporation as "the largest US arms exporter," it appeared that TABD was positioning itself to capitalize on the post-9/11 environment (CEO 2002). The reality, however, was that TABD was limping along.

In certain respects, 2002 was the TABD's year that never was. Business cycles again contributed to TABD's weak showing in 2002. In 1998-1999, many TABD CEOs had enjoyed booming economies, Wall Street success, and what one official called "rock star status." By 2002, with the economy in a significant downturn, the same CEOs were consumed with turning around poor corporate earnings and keeping their boardroom positions. They could not afford to be seen "palling around at a trade policy forum" while their stockholders were watching the quarterly earnings.⁹ European leaders suggested that American CEOs' reticence to become involved was due also to the Bush Administration's lack of commitment to TABD ("Europe" 2003). As a consequence, "big name" CEO participation at the Chicago 2002 TABD conference was lower than at any time since the inaugural conference in Seville. When BAE Systems stepped down as co-chair following the conference, the Brussels TABD office became defunct. Only the US office remained with a single staff person—and only then due to Boeing's willingness to provide office space and basic expenditures.

In the meantime, transatlantic frictions continued unabated in 2002. Tensions surged in January with US President Bush's State of the Union speech in which he referred to Iraq, Iran, and North Korea, as part of the "Axis of Evil" that threatened the US. The speech immediately drew criticism from French officials who questioned the American president's reduction of global issues to a war on terrorism, and from German officials who suggested it was the administration's excuse to settle old scores with Saddam Hussein. That same month, the World Trade Organization affirmed that the US system of Foreign Sales Corporations (FSCs) were illegal export subsidies, thus allowing the Europeans to begin levying "nuclear" sanctions of \$4 billion. In March, US-EU economic relations were further

9 Interview, February 5, 2004.

strained when the President Bush decided to impose tariffs of up to 30% on steel imports. While recognizing that the American president's actions were largely due to the future presidential election, the EU threatened to counter with sanctions worth over \$2 billion (European Report, 2002). European efforts to promote a "positive agenda" at the April 2002 summit were short-lived. In September 2002, the Bush administration released its National Security Strategy, calling for a more militarized approach that would include first-strike options. Most European allies and Bush administration critics viewed the strategy as a significant challenge to "just-war" doctrine. In October 2002, the US Congress adopted a joint resolution authorizing the use of force against Iraq and giving the president implicit first-strike authority. A day after the 7 November 2002, TABD conference in Chicago, the UN Security Council approved Resolution 1441 which imposed new arms inspections on Iraq and warned of "serious consequences" should the resolution be breached. The resolution had been a source of intense negotiations between the Americans, British, and French and provided hope to certain European allies that US military action might be further delayed. This hope was dashed a month later on 21 December 2002, when President Bush approved the deployment of troops to the Persian Gulf region.

The US-EU tensions were not lost on the transatlantic business communities who were nervous about the economic spillover effects in an already weakened global economy.¹⁰ It was not the renaming of "Freedom Fries" in the US Capitol cafeteria or the manifestations at the Paris McDonalds that caused concern. Rather, it was the realization that there were "seismic shifts" in the US-EU relationship, and not just a blow-up over WTO banana wars.¹¹ For CEOs, the tensions grew out-of-hand at the World Economic Summit in Davos, Switzerland, in January 2003, where the US government in particular was derided for its global policies. As one attendee noted, the situation became "surreal." Government officials from both sides of the Atlantic began buttonholing the CEOs to "take sides" on the looming Iraq war and to halt transatlantic trade as a means to punish the other side. The reaction by the business leaders was "fury."¹² Corporate executives' sense that certain government officials had become embroiled in the ideological conflicts, and either had lost sight or had no clear understanding of the US-EU economic interdependence further troubled the CEOs. In Washington, DC, a number of companies began to lobby the US government to step back and to reassess its confrontational relationship with the Europeans. A separate ad-hoc group, the "EU Vanguard Group," comprised of major firms like AOL, GE, and Citigroup, was formed to encourage the government to reengage the EU. One goal of the Vanguard

10 Interview. February 26, 2004.

11 Interview. February 5, 2004.

12 Interview. March 4, 2004.

Group was “to be sure Congress didn’t do anything stupid;” another was to call for some sort of dialogue.¹³ As one US government official noted, “it didn’t matter what it was called, TABD or whatever,” the firms simply wanted a means to reintroduce positive discussion back into the US-EU relationship.¹⁴

Within the US administration, the State and Commerce Departments also grew wary of the increasing US-EU tensions. Grant Aldonas, the Under Secretary of Commerce for International Trade, began to champion the TABD as an important practical means to bring the governments together. Aldonas also regarded the TABD process as a vehicle to “reinvent growth both in the United States and Europe” by lowering transaction costs through improved cooperation on US-EU regulatory issues (US Mission 2003). The study released in Spring 2003 by Dan Hamilton and Joseph Quinlan of the Center for Transatlantic Relations also focused political leaders on the economic importance of the transatlantic relationship (Hamilton and Quinlan 2003; this volume).

On the European side, European Trade Commissioner Pascal Lamy and Enterprise Commissioner Erkki Liikanen continued to advocate the TABD. The political tensions in 2002 had, of course, not only soured relations across the Atlantic, but within the European continent as well. US Defense Secretary Donald Rumsfeld’s jab at the divisions between “Old Europe”—namely, France and Germany who largely disagreed with US policy—and “New Europe”—many of the new members of the EU who—along with Britain and Spain, generally supported US actions in Iraq—were not well received in Brussels. For Lamy and Liikanen, the TABD remained a tried and true mechanism to bring the transatlantic and European partners back to the table. It became clear to them that if the TABD companies couldn’t relaunch the organization, someone else would have to do it.¹⁵

B. Relaunch: Part I and Part II

Just as they did in 1995, it was the government leaders who led the relaunch of TABD in 2003. In April 2003, Commissioners Lamy and Liikanen, and US Commerce Secretary Evans exchanged letters supporting TABD’s relaunch.

Evans, known for being “results-driven” wanted to ensure that the TABD become more effective. The Commission, with the assistance of the Chairman of the Supervisory Board of BASF, Jürgen Strube, began identifying a core group of US-EU CEOs who would be supportive of the initiative. Strube had previously served as one of the first TABD co-chairs, and was the current president of UNICE, the EU business peak association. American officials, including Stuart Eizenstat

13 Interview, March 3, 2004.

14 Interview, February 26, 2004.

15 Interview, February 4, 2004.

—a key government figure in TABD during the Clinton years and co-chair of the European-American Business Council—also helped recruit the companies. Arrangements were made for a special meeting on 24 June 2003, between Liikanen, Evans, and the business leaders to relaunch the TABD in a new format and to stress that the TABD would be “a key interlocutor in ensuring that [...] transatlantic economic issues are addressed” (Commission 2003). The “new TABD” submitted a political statement to leaders of the US-EU summit the following day, noting that the TABD was “born out of a political need for closer interaction” (Werner 2003).

The “new” TABD would draw from the organization’s strengths and avoid some of its weaknesses. The TABD would remain an organization driven by high-level meetings of CEOs and government officials. Gone, however, was the annual conference that had come to define and delimit the organization’s success. Instead, it was agreed that “smaller meetings between CEOs and government principals focused on results more closely tied to the government calendar” would take place, notably in half-day meetings at the time of US-EU summits (Werner 2003). Government and business leaders also agreed that 10-12 companies from each side of the Atlantic would serve as an Executive Board for the two corporate co-chairs leading the organization.

The momentum for the TABD initiative was growing in 2003. UK Chancellor Gordon Brown, for example, encouraged the US and EU governments to restate their commitment to the TABD process. Later, Brown, together with US Treasury Secretary John Snow, announced plans in November 2003 to conduct a joint study identifying barriers to trade in the transatlantic marketplace (“Brown” 2003). The study would be modelled after the European Union’s own Cecchini Report in the 1980s which identified costs associated with the lack of a single European market.

In Brussels, the Transatlantic Policy Network (TPN), an influential think tank comprised of business, European Parliament leaders, and US Congressional leaders¹⁶ involved in transatlantic issues, emerged as an important voice in TABD’s resurgence. By late 2003, the TPN began to wrap up an 18-month study to identify ways to revive the transatlantic relationship. In its report of December 2003, entitled “Strategy to Strengthen Transatlantic Partnership,” the TPN explicitly called for the creation of a barrier-free transatlantic marketplace (BFTM) to be completed by 2015, and possibly 2010 (TPN 2003).¹⁷ The report noted that the initiative would

16 These same US and EU legislators are involved in the Transatlantic Legislators Dialogue (TLD).

17 The TPN report was drawn up by two TPN Co-rapporteurs—Peter Linton of BKSII, Brussels, and Bruce Stokes, Journalism Fellow with the German Marshall Fund of the United States (see also his contribution in this book)—as well as two TPN Advisors—Simon Serfaty of the

not require a free trade agreement or any new treaty, but would focus on domestic impediments to regulatory cooperation. While downplaying any treaty, the TPN proposal was, in fact, a bold initiative. Moving away from the “building blocks approach” of the past, the TPN called for a grand strategy reminiscent of the EU’s own Single Market initiative. The TPN also singled out the TABD to play a prominent role in creating the BFTM.

Not surprisingly, TPN had a strong link to the TABD. It was the same TPN that served as a caretaker for the TABD when BAE Systems stepped down as EU co-chair in 2002. The chair of the EU Business Committee was Hanns Glatz, who had worked intimately on TABD issues when Daimler-Chrysler chaired the TABD. The US Business chair was Lisa Schroeter, the former Executive Director the TABD, who previously worked on TABD matters with EDS, and who was now addressing TABD issues for the Dow Chemical Company. Moreover, at least one-third of the TPN business membership would later serve on the 2004 TABD Executive Committee, including the two TABD co-chairs.

Of course, as a public-private partnership, the TABD also needed high-level business leadership. It would take the Commission, Commerce, and government leaders several more months to identify and cajole two CEOs to assume the co-chair positions within the organization. Finally, on 4 December 2003, US Secretary Evans and EU Commissioner Liikanen announced the Douglas Daft, CEO of The Coca-Cola Company, and Niall FitzGerald, Chairman of Unilever PLC, would be the TABD co-chairs for 2004-5. The recruitment had not come easily. FitzGerald was a solid choice for the position not only because of his interest in larger policy issues, but also because the Netherlands and the United Kingdom—Unilever’s “home countries”—would be presiding over the EU presidency during the formal TABD relaunch. It took strong influence from EU Commission President Prodi, the Prime Ministers of the UK, the Netherlands, and Ireland, and a very high-level level Bush administration official to recruit FitzGerald of Unilever to lead the TABD effort.¹⁸ FitzGerald made it clear to government officials that he would assume the position only if there was a clear commitment from the governments to move forward on the process. Unilever officials created a “demand list” to take to the US government, the Commission, and the UK government insisting on the certain types of support, to which the governments agreed.¹⁹ FitzGerald, in turn, played an important role in recruiting his US colleague, CEO Douglas Daft of Coca-Cola, to be the American co-chair. In a *Financial Times* commentary, the two co-chairs discussed their role as CEOs of “transatlantic” companies in the TABD. While

(contd.)

Center for Strategic and International Studies (and host to the US TABD office), and Lord William Wallace of Saltaire of the London School of Economics.

18 Interview with US business officials, March 4, 2004.

19 Interview with TABD official, March 4, 2004.

recognizing that jobs and competitiveness were important reasons for renewing the TABD process, the chairmen also cited the need “to foster greater transatlantic cooperation at this critical time.” The larger goal of the TABD was to “try to prevent current US-European diplomatic tensions spilling over into the economic sphere. It is not the business community’s role to heal this rift. But we do believe that a renewed strategic vision for TABD can provide a positive agenda [for government cooperation]...” (Daft and FitzGerald 2004).

TABD’s formal rebirth took place at the January 2004 World Economic Forum when the newly recruited TABD business chairs were present along with Secretary Evans, and Commissioners Liikanen and Lamy. Evans went to Davos explicitly for the TABD meeting. At the TABD meeting, the companies agreed at the business-only session that they should concentrate their efforts on only a small group of “‘horizontal,’ cross-cutting issues” and that the TABD CEOs “must take full ownership of these issues” (TABD 2004d). In addition, they agreed to focus on a number of core policy issues: 1) WTO Doha Development Round; 2) Intellectual Property Protection and the Fight against Counterfeiting; 3) Capital Markets; 4) International Accounting Standards; 5) Corporate Governance; 6) Regulatory Coordination; 7) Regulatory Sub-sectors (sectoral regulatory issues such as chemicals); 8) Open Markets and Security.

Echoing the objective identified in the TPN report a month earlier, the TABD business and government leaders called for the creation of a barrier-free transatlantic marketplace. A similar call was made by Spanish Prime Minister Aznar a week earlier at a Washington, DC conference. The Davos meeting participants also noted the strong support shown by the US government, European Commission, and European Council. They agreed, however, that “if the TABD determines that political backing from the governments were to decline significantly, members could choose to disband the TABD” (TABD 2004d). The warning, although explicit, was not necessary. As one government official explained, after all the work to reenergize the TABD, “no one wanted this to fail.”²⁰

C. TABD Reorganization

Like many of the chairmen before them, Daft and FitzGerald sought to restructure the TABD. Building on the agreements outlined in government-business discussions of June 2003, Daft and FitzGerald decided to make TABD much smaller by design. The US and EU have 15 members each on the Executive Board. (See Table 2 below.) With the Commission’s assistance, European companies were recruited in part to balance the companies’ country of origin, and therefore, the support of the Member States. Efforts also were made to recruit small and medium-

20 Interview, March 16, 2004.

Table 2
2004 TABD Co-Chairs and Executive Board

2004 TABD Co-Chairs	
E. Neville Isdell, The Coca-Cola Company*	Niall FitzGerald, Reuters (Unilever)
Executive Board Companies	
Bison Gear and Engineering Corp.	Arcelor
Citigroup	AstraZeneca
Deloitte Touche Tomatsu	BASF*
The Dow Chemical Company*	British Airways
EDS*	British American Tobacco
Ernst & Young	Deutsche Bank*
The Estée Lauder Companies	Ericsson
FedEx	KPMG International
General Electric*	Lafarge
Merck and Co, Inc.*	Philips*
PricewaterhouseCoopers	Renault
Time Warner*	Repsol
Tramco Inc.	SAP*
UPS*	SEB
Visa International	Unilever*

* Denotes TPN member

sized enterprises that would serve as the voice of the US Chamber of Commerce, the National Association of Manufacturers, and UNICE—providing further representativeness and “legitimacy” to the organization. It was agreed that TABD companies would serve as the Executive Board members and would also contribute \$25,000 or 25,000 Euros to cover TABD costs. In the past, TABD co-chairs bore all major costs of the organization.

As part of Daft’s imprint, the US business organization is now housed in the Center for Strategic and International Studies (CSIS), a Washington, DC think

tank.²¹ The CSIS has provided the US TABD group with strategic thinking on how to advise the governments. It provides a more neutral meeting place for the companies and government officials to meet. The think tank also serves as an outreach mechanism for the larger DC think tank community to ensure broad consensus on the issues (TABD 2004a). The EU business grouping, although housed within Unilever, also works with individuals at the European Policy Centre for strategic guidance. Both think tanks have strong links with the TPN as well.

In a final move to strengthen the organization, it was agreed that the TABD co-chairs would preside for two years, as opposed to one. The purpose was to provide greater continuity to the organization. Now that the financial burden was shouldered by all TABD Executive Board Members instead of the two co-chairs, this was feasible. Yet, in what can only be attributed to the "curse of the TABD co-chairs," both TABD co-chairs found themselves pressured into retirement by their own corporate boards in February 2004. First, FitzGerald announced that he would be retiring at the end of September 2004, but that Unilever would continue to support him as co-chair of TABD. FitzGerald would later become chairman of Reuters. Days later, Daft announced his plan to retire from Coca-Cola by the end of the year. He was later replaced by E. Neville Isdell who pledged to continue serving as TABD co-chair. Despite the change in the TABD co-chair's status, the TABD organizational structure remained stable.

The TABD began by focusing on four priority areas:

- 1) Open Trade and Security—to ensure that open trade and the fight against terrorism are complementary and not competing objectives, such as in the area of express shipping;
- 2) Intellectual Property Rights and the Fight against Counterfeiting—to recognize the importance of protecting intellectual property rights;
- 3) Capital Markets and International Accounting Standards—to ensure that the company voice is heard to bridge the gap by 2007 between the new International Financial Reporting Standards with the US Generally Accepted Accounting Principles; and
- 4) World Trade Organization and the Doha Development round—to ensure that the US and EU move forward on Doha, notably in the area of agriculture (European Commission 2004).

21 While the CSIS affiliation allows for larger meeting space, logistic support, and strategic guidance given the relative small size of the DC Coca-Cola Public Affairs office, the CSIS's 501c3 umbrella under which TABD functions allows the companies to count their \$25,000 as a tax-exempt contribution.

At the same time, it continued to promote the larger goal of a barrier-free transatlantic marketplace—an undertaking that would require significant new forms of US-EU regulatory cooperation.

V. Assessing the Future

With the success of TABD's relaunch at Davos, a number of key government and business actors began to speak out in favour of the TABD's agenda. In February 2005, the TPN formally launched its report at the Centre for European Policy Studies in Brussels, calling again for the BFTM's creation. In April, TPN members of the European Parliament succeeded in passing a resolution on EU-US relations and the transatlantic marketplace (Hoedeman, 2004). In May 2004, a number of key US and EU business groups and associations issued a joint statement calling for "a new, more ambitious transatlantic trade and investment initiative"—namely, the BFTM (USCIB 2004).²² Leading the initiative was a familiar name, Jürgen Strube, president of UNICE and former TABD Chair.

The actions were well-timed for the US-EU Summit on 25-26 June, at Dromoland Castle, Ireland. On 25 June, several TABD Executive Board members—14 CEOs from the US and EU—met with several senior officials from the US administration, the Commission, and the Irish presidency to finalize TABD recommendations. The following day, TABD co-chair Fitzgerald and TABD Executive Board member and then-acting TABD co-chair Michael Eskew, Chair and CEO of UPS, delivered the TABD report to President Bush, Bertie Ahern, the President of the EU Council and Taoiseach of Ireland, and Romano Prodi, President of the European Commission (TABD 2004c).²³ As the TABD press release trumpeted: "The TABD's goal of a barrier free transatlantic market took an important step forward today [with the presentation of the TABD recommendations]... The TABD will now begin work on a detailed work plan for achieving its goal in close cooperation with the governments" (TABD 2004c).

Of course, press headlines about the US-EU Summit naturally focused on Iraq, the Middle East, weapons of mass destruction, counterterrorism and non-proliferation. Yet the summit also produced a number of important documents on the transatlantic economic relationship. The summit produced a declaration,

22 The signatories included UNICE, Business Roundtable, CSI (Coalition of Service Industries), EABC (European-American Business Council), ECAT (Emergency Committee for American Trade), NAM (National Association of Manufacturers), NFTC (National Foreign Trade Council), OFII (Organisation for International Investments, and USCIB (United States Council for International Business).

23 Members of the Transatlantic Consumers Dialogue boycotted the summit upon learning that the business dialogue, but not the consumer dialogue, would meet with these government officials. See TACD, 2004.

“Strengthening the Transatlantic Economic Partnership” that supported government efforts “to explore means to eliminate trade, regulatory, and investment impediments to further economic integration [between the US and EU]” (White House 2004b). As noted in the statement, these efforts may include the relevant regulatory agencies. An accompanying factsheet welcomed recommendations concerning the creation of a barrier-free transatlantic market. It also identified US plans to convene a series of public meetings with representatives from business, labour, consumer and environmental groups, and academia to develop a US strategy on how to achieve this economic integration.

The leaders also produced the “US-EU Regulatory Cooperation Roadmap” designed to provide a framework for cooperation on a broad range of issues including pharmaceuticals, auto safety, information and communications technology, cosmetics, consumer product safety, chemicals, nutritional labelling, and eco-design of electrical/electronic products. Again, the goal was to minimize US-EU regulatory differences in these areas through careful consultations.

Finally, government leaders welcomed the joint report from US and EU officials participating in the Financial Markets Regulatory Dialogue (see Posner’s contribution to this volume).

While the US presidential elections and the arrival of the new Commission shifted considerable focus away from these US-EU initiatives, progress was made on a number of fronts. On 17 August 2004, the USTR issued a notice and request for comments on the “Public Dialogue on Enhancing the Transatlantic Economic Relationship” in the Federal Register. The US government’s objective in this “Stakeholders Dialogue” is “to stimulate concrete ideas from interested stakeholders for specific government actions that could enhance US-EU economic integration” as called for in the White House Fact Sheet at the US-EU Dromoland Castle Summit (USTR 2004). Indeed, the dialogue is not designed to debate whether or not a barrier-free transatlantic marketplace is desirable (at least from the perspective of certain consumer and environmental groups), but on how to achieve it.²⁴ Suggested topics to be explored in the dialogue include: “Where should the US and EU economic relationship be in 10 years and what steps should we take to meet these goals?” “What should be done to better mesh US and EU regulatory approaches?” “What should be done to further liberalize transatlantic trade in services?” As one government official pointed out, the Stakeholders Dialogue directly addresses the TABD goal of creating the barrier-free transatlantic marketplace.²⁵ Based on comments from the Stakeholder Dialogue, the US government will prepare a report

24 As noted in the White House Fact Sheet, “We will benefit from the advice of business, consumer, and other groups who share president Bush’s goal of broad-based growth and economic opportunity” (White House 2004a).

25 Interview, December 13, 2004.

of key recommendations to be presented to US government leaders prior to the 2005 US-EU summit.²⁶

The “Stakeholders Dialogue” is a significant departure from the transatlantic dialogues created under the Transatlantic Economic Partnership (TEP) in 1998. This is not a “Dialogue of Dialogues” among the TABD, TACD, and other dialogues. Rather, it is designed as a dialogue around the specific BFTM goal that, at least according to press accounts, both governments accept. As discussed below, whether or not this will be regarded as a “legitimizing dialogue” in the eyes of traditional stakeholders is yet to be determined.

By December 2004, a number of discussions were underway between US-EU government and industry officials on TABD recommendations. Certain TABD companies were readying themselves to participate in specific sector discussions of the US-EU Regulatory Cooperation Roadmap. The TABD was also tracking developments in its four priority areas, and was pleased with the progress to date in areas such as Intellectual Property Rights and Anti-Counterfeiting as well as the efforts to promote the BFTM.²⁷

A. Strengths and Weaknesses

While government and business officials are pleased with TABD’s turnabout, reviewing TABD’s four key strengths and weaknesses provides a greater appreciation for the extensive nature of the organization’s transformation. First, the TABD rid itself of the annual conference that defined the organization in a manner both positive and negative. In doing so, the TABD “lost” the public face to the organization as well as the public momentum for further cooperation. At the same time, it no longer tied its fate to the vagaries of a single annual conference. By focusing its meetings around the Davos summit in January and the US-EU summit in June, the TABD has created for itself a schedule that is more in tune with the government calendar as well. Of course, the lack of a public conference has meant that TABD protesters can now focus their activities on Davos as well as the US-EU summit.

The second important change is in the TABD agenda itself. Historically, the TABD focused on a “building blocks approach” which lent itself to step-by-step consolidation, but often resulted in an organization without a clear goal. By far one of the most important changes to TABD in 2003-4 has been its formal adoption of the goal of a Barrier-Free Transatlantic Marketplace. While supporters are careful to note that the BFTM will not entail a free trade agreement, the BFTM has the

26 On November 9, 2004, USTR issued an update on the Public Dialogue, extending to December 31, 2004, the submission of written comments regarding ideas on how to deepen transatlantic economic ties.

27 Correspondence, December 5, 2004.

potential to become a dynamic project similar to the EU's adoption of its own single market. In this sense, the BFTM is a far more radical idea and arguably more prone to public protest than any transatlantic free trade agreement could ever engender. It thus remains to be seen whether or not the TABD's "practical focus" can continue in light of this more radical proposal.

A third significant development is the TABD's attempt to address problems associated with its political nature and political/business cycles. While these cycles are inevitable, the TABD's new format and calendar may be better suited to adjust to them. In the past, for example, the TABD found itself holding its November summit in the midst of a presidential election and/or at a time of a lame duck president. Whether purposively designed or not, the new meetings scheduled around US-EU summits and Davos avoid this problem. Also positive are the TABD's decisions to create 2-year terms for the co-chairs and to spread the organization's financial support among the Executive Committee. Historically, considerable time and effort was spent in recruiting TABD co-chairs each year—a process that oftentimes stopped any progress on activities until the new individuals were on board. Moreover, the organization faced significant financial constraints if either co-chair stepped down from office. The new arrangements, while not avoiding business cycles, now allow for greater leadership and more secure financial support within the business community.

Finally—and most importantly—is the institutional set-up of transatlantic regulatory policymaking. It is on this point that the TABD's future is less evident. What companies call a "lack of political will" is in reality the governments' limited ability to transform domestic regulatory structures. As US and EU policymakers have come to accept, it is not merely the EU and EU regulatory policies that diverge, but the regulatory structures themselves. In broad terms, the European Union has developed through its single market program a means to coordinate transnational and therefore, transatlantic regulatory policy positions. That these policy mechanisms are not always transparent is now being addressed through the Guidelines of US-EU Regulatory Cooperation. The United States, on the other hand, has formal rulemaking procedures as identified in the Administrative Procedures Act. What the US is lacking, however, is the specific means to coordinate transnational and therefore, transatlantic cooperation on regulatory issues. In general, US regulatory agencies have the mandate and the funding to focus on domestic regulatory policy issues. These agencies, who can enjoy a fair amount of independence on policy and implementation procedures, are not necessarily designed to address the "trans-domestic" issues for which the TABD's barrier-free transatlantic marketplace calls.

The Bush Administration's "Stakeholders Dialogue" may be a first step in providing the political justification for institutional change in regulatory agencies and policies. The dialogue itself, however, cannot engender the transformation in

culture and practice necessary to create the BFTM envisioned. Whether or not the Bush administration will have the time and political capital to take on these regulatory reforms in light of other high profile domestic and international issues (i.e. the war in Iraq, the budget deficit, social security, etc.) also is unknown. Yet failure to address regulatory reform will undoubtedly lead to the TABD's decline once again as corporate executives lose faith in government support for the initiative.

VI. Conclusions: Calming the Waters?

In a period of tumultuous transatlantic relations over Iraq, the Middle East, and the larger war on terrorism, it is perhaps surprising that US and EU government officials on both sides of the Atlantic would spend so much time and effort to revive the Transatlantic Business Dialogue. It is also instructive to understand why they would do so.

As one official noted, "Iraq saved TABD."²⁸ At the same time, the TABD process provided government officials the opportunity to save themselves from their own ideological warfare over the Gulf state. Since its inception, TABD's *raison d'être* has not only been economic (to promote regulatory cooperation and ultimately, to promote economic growth), but also political. The TABD has provided a practical means to bring government and business officials to the negotiating table to find both their commonalities as well as their differences. In this sense, the TABD has helped to calm the waters of the US-EU economic and political relationship.

To be sure, the future of the TABD as well as the larger US-EU economic relationship is unclear. On one hand, the TABD has undergone significant change in recent years. The goal of creating a barrier-free transatlantic marketplace has prompted new dialogue on US-EU regulatory cooperation. That the US and EU governments have strongly supported these developments is in itself a positive sign for the TABD's future. Yet, the larger TABD goal cannot be achieved without serious efforts to reform regulatory rulemaking procedures and agencies, and to address the concerns of stakeholders who do not welcome the larger BFTM initiative.

As several government and business officials noted in the past five years, "if the TABD didn't exist, you would have to create it." Learning how to use it to promote transatlantic economic relations remains the challenge of this public-private partnership.

28 Interview, February 5, 2004.

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Comments

Hugo Paemen

Maria Cowles very well explained the origins of the Transatlantic Business Dialogue (TABD) and the conditions under which it has been working since its creation. Having been set up with the strong support of the US Department of Commerce and the European Commission, it was soon integrated in the renewed efforts for deeper ties and cooperation between representatives of various sectors in both societies, as put forward in the New Transatlantic Agenda (NTA) in 1995. Following the TABD model, the NTA promoted similar "dialogues" between representatives of the Unions, consumer organizations, environmental organizations and also between the US Congress and the European Parliament (the so-called Legislative Dialogue).

The TABD has thereupon been considered as one of the success stories of the NTA. But it lost some of its initial momentum after three or four productive annual meetings, attended by an impressive number of CEO's of American and European companies. Successive efforts afterwards to regain the initial impetus seem to indicate that the basic idea of the dialogue is still considered worth pursuing by at least part of the two business communities as well as by the public authorities.

The concept of having permanent "dialogues" between the main components of the civil societies on both sides of the Atlantic reflected well the spirit of a renewed partnership, as it was outlined in the NTA. Deeper cooperation could not only be the task of the governments. As both societies were growing closer, it responded to the spirit of the times to offer civil society representatives the opportunity to discuss their (similar) problems and concerns, in order to explore common approaches to

solutions, which could then be submitted for decision to the governments on both sides.

This attractive, but rather idealistic approach, which also aimed at bringing the decision-making processes somewhat closer to the people, was soon confronted with the harsh reality of different legislative, regulatory, organizational traditions on the two continents. Most interest groups, NGO's and professional organizations remained indeed closely tied up with the national, if not local and social administrative cultures. At the level of the governments, the political authority needed for the follow-up and the implementation of the recommendations was not always there.

As far as the TABD itself is concerned, its CEO driven structure makes its activity largely dependent on the leadership exercised by the annually changing presidencies. In fact, most of the driving energy and political input has rather come from the two administrations (US Department of Commerce and the European Commission). For them the "dialogue" is evidently a useful vehicle for general discussion, consultation and stocktaking with an important part of their constituencies. On most issues they are also in a better position to produce the background material, as well as the political assessment for the discussions, most of which have already taken place at the level of their officials. This top-down procedure, without permanent administrative support, favours the trend for leadership to be exercised by the representatives of the governments and probably explains some lack of durable motivation on the side of the private sector, as well as the uneven results of this dialogue.

During its most productive period the TABD managed to have the governments accept, in 1997, six Mutual Recognition Agreements in sectors like pharmaceuticals, telecom equipment, medical devices, etc, but the economic impact of these agreements was finally limited, largely due to the already mentioned lack of consistent follow-up and implementation by the bureaucracies on both sides.

To underline, however, the importance which both administrations attach to these contacts, the two private co-presidents of the TABD have been regularly invited to meet the political leadership at the occasion of the annual US-EU summit meetings. No other dialogue has until now been considered worthy of the same treatment by the summit participants. In 2004, the representatives of the consumer organizations on both sides were offered a discussion only with some high officials who accompanied the summit participants. In protest of this discriminatory treatment they refused to take part.

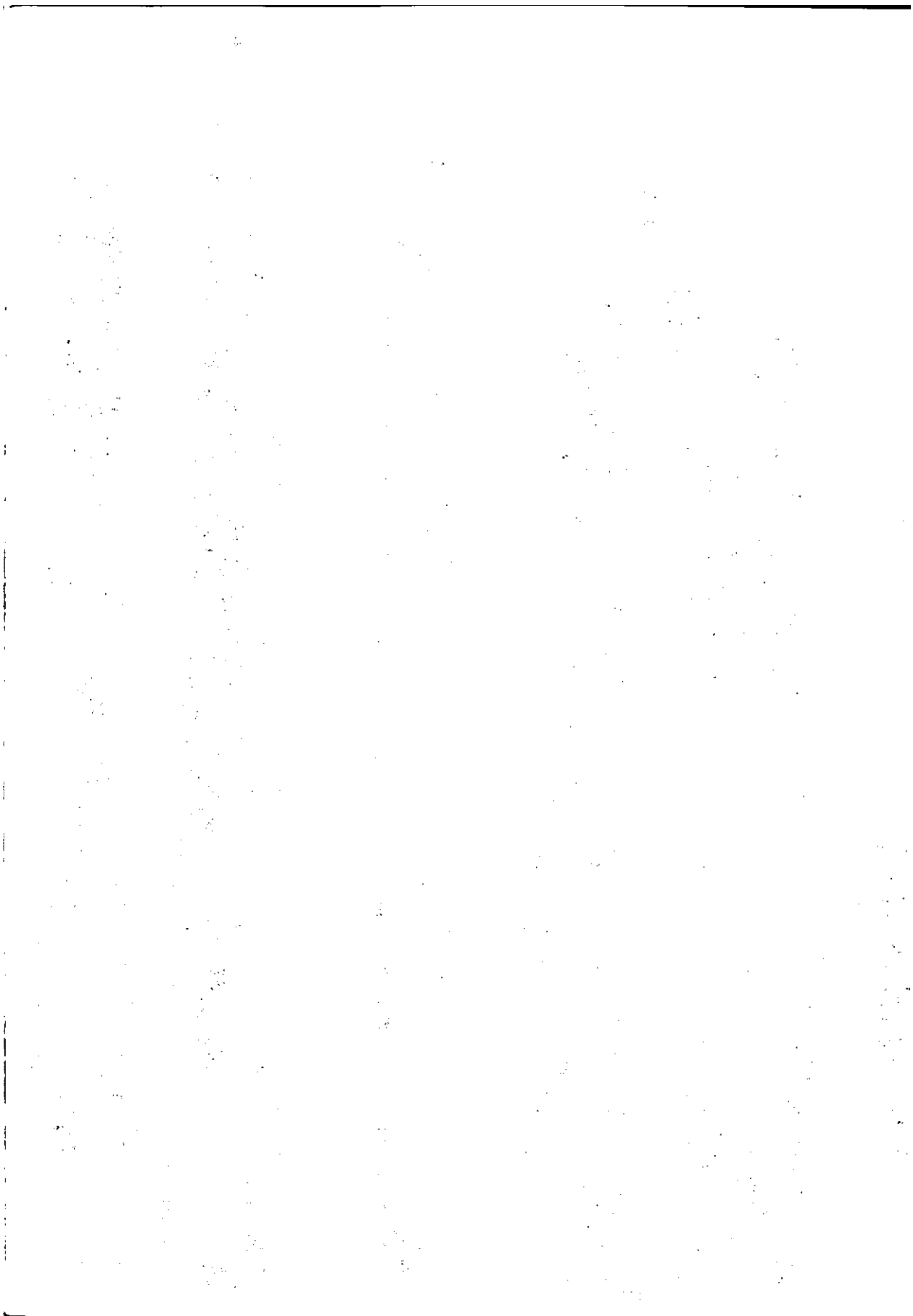
For the TABD, the undeniable promotional potential of these meetings could not always be valorised as it became part of the annual pressure for "deliverable results", which comes along with their political nature. Recently, the meetings with the business leaders at these summits have mainly consisted in the latter handing

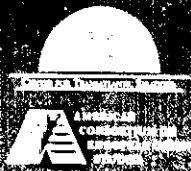
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over a list of recommendations, which the political authorities consistently and politely promised to give careful consideration.

It seems that the effectiveness of the "dialogues" will largely depend on the structure which the private representatives provide for their regular participation. The TABD is in that respect already more advanced than are the other interest groups. However, its top-down, CEO driven organization will probably have to be complemented by a bottom-up, consistent issues management at the level of the daily market operators. On the side of the governments, a more open approach in the discussions and, particularly, a closer follow-up and more methodical implementation procedures, adapted to each sector, would greatly increase the trust and credibility of the dialogues.







Center for Transatlantic Relations
at Johns Hopkins University



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