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## America's Economic Partnership with Europe

by Stuart E. Eizenstat

The United States and the European Union (EU) have a long tradition of working together to improve the global economy, ease tension in sensitive regions, and liberalize barriers to trade and investment to the benefit of our economies. The steady growth of our bilateral economic relationship has been one of the great success stories of the last fifty years. Beginning with the Marshall Plan, which protected Western Europe from Soviet aggression by helping it rebuild its industrial base, the relationship has grown into a multifaceted partnership in which the United States and the EU are each other's largest source of trade and investment, as well as close allies in their relationship with the rest of the world. Our markets are compatible, our business people are outward looking, and we feel comfortable selling and investing in each other's markets.

From any perspective, the depth of our economic relationship is impressive. The EU will purchase more than \$250 billion in goods and services from the United States this year, one-fifth of our total exports. For its part, the EU's exports to our country have risen almost 70 percent over the past five years. An ever growing variety of products come to us from the other side of the Atlantic, offering consumers wider choices, quality products, lower prices, and a rising real standard of living.

Nearly 45 percent of U.S. investment overseas is in EU countries. EU investment in the United States has doubled in the past five years. Its firms are an increasingly common part of our economic landscape. One in twelve manufacturing jobs in the United States is in a European-owned factory. Within the last two years, EU companies have acquired the third largest U.S. automaker, the eighth largest U.S. bank, and the number three manufacturer of Internet browsers.

Our growing economic bonds have helped make us close partners in world diplomacy. Repeatedly, it has been shown that when the United States and Europe act in concert, their common challenges can be overcome. We cooperated militarily through NATO in the Gulf War and are cooperating in Kosovo and Bosnia. We joined to help rebuild the Balkans through the Southeast Europe Stability Pact, encouraging the transition to free markets as well as accomplishing postconflict reconstruction and sharing the view that increased trade rather than permanent aid is the best path to sustainable prosperity and stability. The presence of the secretary-general of the European Council at the summit talks at Sharm el-Sheikh, at the height of the recent crisis in the Middle East, was evidence of the EU's heightened visibility on the world scene

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and presaged even greater collaboration between our countries in the future. The continued strength and success of our transatlantic partnership cannot be taken for granted, however, and will require continued attention to the disputes that arise between us.

## FOUNDATIONS OF THE RELATIONSHIP

Today's U.S.-EU economic relationship had its genesis in the European integration movement that followed the destruction of World War II. Postwar European statesmen such as Konrad Adenauer of West Germany, Ernest Bevan of the United Kingdom, Paul-Henri Spaak of Belgium, and Alcide de Gasperi of Italy, looking back at the experience of the 1920s and 1930s, recognized how cycles of trade protection and retaliation such as the Smoot-Hawley tariff in the United States and the European colonial preference schemes had cut world trade by nearly 70 percent, contributing greatly to the unemployment and social tensions that fueled a new World War. They agreed that the surest road to permanent peace and security in Europe was through gradual economic union. Practical visionaries such as Jean Monnet and Robert Schuman of France and Ludwig Erhard of West Germany saw that if a modest start could be made pooling national production of coal and steel, it would be possible to build success upon success until Europe one day could have one external tariff, one central bank, one currency, and one market. Their dreams have been realized.

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### **The continued strength and success of our transatlantic partnership cannot be taken for granted.**

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The reduction of trade barriers was one of the factors in the victory of the free market system over its communist rival. While Western Europe was forming a Common Market of free democracies, the former Soviet Union did little to encourage its satellite nations to trade with one another. When the peoples of Eastern Europe looked west and saw the growing disparity between their living standards and those of people in states that did engage in such trade, it gave them an additional incentive to break free from totalitarian rule. One measure of the success of the EU's model in improving living standards on the Continent is the fact that 13 states, mostly in Eastern and Central Europe and the Balkans, are currently applying to join it.

The United States, looking back on its own history, has always encouraged the economic and strategic integration of Europe. The newest political dimension of our relationship was a deliberate act of strategy on our part. In the early 1990s, as Europe was freeing itself from its cold war burdens, several officials of the Clinton administration, myself included, realized that the foundation of the alliance could no longer be the fight against Soviet communism. We also saw that, just as Europe's integration had proceeded faster and further than predicted, so too were technology and business enterprise quickly creating a single global market for many products and services. We

concluded that the United States had to anchor its relationship with Europe in a new agenda and a broader foreign policy vision, so that the two could pursue multiple goals together.

Out of this change in strategy came the New Transatlantic Agenda, which I helped negotiate with the EU. President Clinton and the leaders of Europe signed it in 1995. The agenda staked out four broad areas for U.S.-EU collaboration:

1. the promotion of stability and democracy throughout the world;
2. the coordination of rapid responses to global challenges such as international terrorism, environmental concerns, and infectious diseases;
3. the expansion of world and bilateral trade; and
4. the promotion of more people-to-people contacts through commerce and education.

Many recent initiatives, such as the response to the Asian financial crisis, debt forgiveness for highly indebted poor countries, and accelerated vaccination programs against HIV, malaria, and tuberculosis are grounded on these goals. The agenda created a Senior Level Group to permit more regular high-level exchange, try to resolve difficult bilateral disputes, and help prepare the biannual EU-U.S. summits.

## PARTNERS AND COMPETITORS

It is necessary to recognize that the United States and EU are competitors as well as partners. In every region of the world and in many important sectors—agriculture, steel, and aircraft manufacture, to name just a few—our firms and theirs vie for customers, markets, and contracts. Numerous government-level disputes grow out of this contest, occasionally causing tension. But while some believe that EU growth and prosperity can only come at the expense of American economic progress, the U.S. government's position is quite the opposite. We do not view the relationship as a zero-sum game. We firmly believe that the combined strength of Europe and the United States is great enough to allow both of us to pursue a global agenda that supports democracy and open, competitive markets in all countries. The stronger Europe is, the better a partner she can be. In that spirit, I would like to refer to some of the current issues in the trade area and consider how we might avoid others in the future.

*The Framework.* Trade disputes are a thorn in the side of the U.S.-EU relationship. Negotiations to liberalize world trade in agricultural goods and services began earlier this year, as mandated at the end of the Uruguay Round; but Washington and Brussels are still trying to reach agreement on an agenda for a broader negotiating round. Clear rulings by World Trade Organization (WTO) dispute panels, designed to free up trade in specific goods such as beef and bananas, have been resisted by the EU, authorizing retaliation measures by the United States. Efforts by the EU to retain special tax treatment for its exporters while challenging similar treatment for U.S. exporters have also led to confrontation.

To understand these developments requires some historical background. Beginning with the founding of the General Agreement on Tariffs and Trade (GATT) and

proceeding through seven subsequent negotiating rounds, the world's states were able to dramatically reduce external tariffs and other restrictions on trade. In the Uruguay Round, which began in the late 1980s, they fundamentally reformed, updated, and modernized the GATT to meet the demands of a more integrated, technologically advanced world. The result was the WTO, which took over from GATT in 1995. The GATT had consisted of a limited set of essentially unenforceable rules that applied differently to different groups of member countries. The WTO has a more comprehensive set of rules, arrived at by consensus, that apply to all members, with a limited number of special rules for less developed countries.

Most observers would agree that the crown jewel of the WTO structure is its dispute-settlement provision. While a procedure for settling disputes existed under the GATT, there were no fixed timetables, rulings were easier to ignore, and cases dragged on for a long time, often inconclusively. The WTO has a more structured process with more clearly defined stages. Panels of independent experts make initial decisions. There is a timetable for settling disputes, with flexible deadlines at various stages of the procedure. Perhaps most significantly, the losing country cannot block adoption of the ruling, as was possible under GATT. WTO rulings are automatically adopted unless there is a consensus to reject them. As a result, in order for a country to block a ruling, it must persuade all the other members—including its adversary in the case—to share its view. If a member state ignores a ruling, there is an allowance for retaliatory tariffs against the offender's trade. The amount is generally determined by the value of trade lost because of the trade-distorting practice.

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*Areas of Dispute.* The dispute over banana imports is a useful illustration of the dispute-settlement provision at work. Europe is the world's largest market for bananas, importing some 4.5 million metric tons a year. In 1993, the EU established an import licensing system for the product that favored producing countries that are former European colonies and excluded a number of developing-country producers whose bananas are marketed by U.S. private enterprise. Under the GATT's pre-Uruguay Round dispute-resolution procedures, the EU ignored two GATT panel reports that recommended changes to the licensing system. A more recent ruling by the WTO's Disputes Settlement Body also has not been implemented. Under the rules of the WTO, if a country persists in enforcing a trade practice that a panel has found to be inconsistent with WTO rules, the state whose trade is adversely affected is entitled to retaliate by suspending existing trade concessions up to the amount by which its trade has been damaged. Availing itself of this right, the United States has imposed steeply higher tariffs on European exports up to \$191 million, the level of damages established by the WTO.

While suspending tariff concessions has not resulted in rapid changes to the EU's banana regime, it has brought about pressure that has focused the EU on resolving this problem and demonstrated that it is in the EU's own interest to do so. In addition, the WTO procedure provided a framework for ultimately achieving a fairer EU banana regime than ever would have been possible absent those procedures.

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I hope this will also be the case with U.S. exports of beef. For the past thirteen years, and again in defiance of GATT and WTO rulings, the EU has banned U.S. beef exports that have been treated with hormones designed to shorten the time in which cattle reach the weight necessary for marketing. The EU justifies its action on safety grounds, even though the World Health Organization, the United Nations, and the Lamming Committee, a scientific body convened by the European Economic Community itself, has declared hormone-treated beef safe for human consumption. As a result of the failure of the EU to comply with WTO panel rulings, the United States has been authorized to impose additional retaliatory tariffs of \$117 million.

An especially serious current trade dispute arises from the WTO's ruling concerning the method by which U.S. laws exclude from taxation certain income of subsidiaries of U.S. corporations that engage in foreign sales. The WTO has ruled that this exclusion is prohibited because it is an export subsidy. The United States generally employs a "worldwide" tax system, based on the residence of the taxpayer, whereby income of a firm incorporated in the United States is subject to tax even though it is earned from foreign sources. For foreign sales corporations (FSCs), however, it developed a tax system that emulates certain aspects of the "territorial" system, used by many EU countries, whereby only income earned within each country's borders is subject to tax. It is recognized that the territorial system can result in exports' being taxed more favorably than comparable domestic transactions. The FSC was thus created to level, at least partially, this playing field.

FSC stood without challenge for some fifteen years. Nonetheless, beginning in 1998, the EU successfully challenged it in the WTO, which ruled that it was an illegal export subsidy. Notwithstanding our strong disagreement, the United States has worked hard to respond to this decision by developing bipartisan legislation repealing FSC and creating a new system that meets the main objections lodged by the EU. The legislation was passed in Congress and was signed by President Clinton in November 2000. Under the new system, the general rule is that no income earned from sales of goods abroad is subject to tax, whether or not the income flows through an FSC. Because our government refrains from imposing a tax in the first place, rather than forgoing revenue otherwise due to it, the system is not a subsidy under the test outlined in the WTO decision. The new system is also not contingent upon exporting. It

defines the “extraterritorial income” exempted from taxation without regard to whether a good is manufactured within or without the United States. The European Commission, the arm of the EU with competence for trade matters, has stated that it will challenge our new system on the grounds that it is still an export subsidy. We regret that the European Commission has not accepted this legislation.

Nonetheless, following recent bilateral negotiations, the European Commission agreed to pursue a review of the WTO consistency of this legislation first, and to hold in abeyance the imposition of retaliatory sanctions until the outcome of that review is known. I have been reassured that the commission will adhere to this agreement. The stakes involved in this dispute are very high. As of this writing, the EU has threatened to impose sanctions in excess of \$4 billion a year, an amount that the United States strongly contests. But they will now suspend efforts to retaliate while we seek to persuade the WTO that our new legislation is consistent with its requirements. For this reason, it is critical that we continue working together to resolve our differences in a creative and consultative manner.

In the area of agriculture, EU policies do not fully recognize the fact that the mechanization of farming has made it possible for countries to grow more food with far less labor. Fully half the total EU budget—\$7 billion a year—is used for subsidy payments to the 2 percent of its population engaged in farming. This bloated subsidy protects inefficient farming, hurts farmers who are competitive with foreign producers, drains government budgets, and limits the choices available to European consumers of food and fiber.

While the WTO meeting in Seattle in December 1999 failed to launch a new round of trade talks, negotiations on agriculture matters were already on the table, having been mandated by the Uruguay Round. The agenda proposed by our government last summer would reduce substantial disparities in tariff levels between countries. It would attempt to eliminate export subsidies through annual reduction commitments and to cap trade-distorting domestic price support payments as a percentage of total agricultural production. Our proposal is not Draconian. It would allow governments to provide an adequate income safety net, research funds for new agricultural technology, and disaster relief aid. But it would go a long way toward allowing trade in agricultural goods to be determined not by artificial government payments but by the quality of the product and the efficiency of the producer. Our proposal has the support of most of the food-exporting countries outside the EU.

Another area of dispute concerns hushkits: advanced technology mufflers installed to reduce aircraft noise from jet engines. They have been installed in U.S.-manufactured aircraft to meet internationally recognized noise standards set by the International Civil Aviation Organization (ICAO), a UN specialized agency that establishes uniform international aviation standards so that airlines and aircraft makers do not have to meet different standards in different countries.

In 1999, the EU adopted a regulation restricting the operation within its borders of aircraft modified to meet the most stringent international aircraft noise standards with noise-suppression technology, including hushkits. Because it relies on a carefully

chosen design standard that excludes U.S.-manufactured aircraft engines, rather than a nondiscriminatory performance standard, the regulation not only damages the effectiveness of global standards for aircraft noise established in the ICAO, with serious repercussions for the U.S. and EU aerospace industries, but also does little or nothing to reduce noise around European airports. U.S. industry has estimated the regulation's economic harm to the United States at more than \$2 billion, including depreciation in the value of the U.S. fleet and lost sales of hushkits and replacement engines.

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### **States need to be more creative in how they solve the complex and difficult issues they encounter with their trading partners.**

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In response to the EU's regulation, and after extensive but unsuccessful diplomatic efforts to resolve the dispute, the United States filed a complaint in the ICAO, charging that the proposed ban was a violation of the International Convention on Civil Aviation. We seek to compel EU member states to honor their international obligations related to ICAO noise standards, and ultimately to indefinitely suspend or withdraw the hushkit regulation.

Sanctions is another area in which the United States and the EU often work together but sometimes have had to reconcile differing views. Properly designed, implemented, and applied as a part of a coherent strategy, economic sanctions are a valuable tool for enforcing international norms of behavior and protecting our national interests. In fashioning sanctions legislation, it is essential that the Congress give our president broad flexibility, including the authority to waive some of its provisions, as accords his role as the constitutional implementer of U.S. foreign policy. For example, the president must be able to trade off sanctions measures to get international consensus for actions that may have a greater impact upon the sanctioned country, or even directly negotiate with that country to modify its behavior.

Unilateral sanctions, although they can be resorted to at times to defend national values, are rarely effective. Especially in an era of globalization, sanctions must have broad multilateral support, as the ability of any one country to unilaterally deny key economic benefits to a particular country is limited. The United States and the EU have often cooperated to make sanctions effective by giving them a multilateral dimension. This approach did much to end the apartheid regime in South Africa at the start of the 1990s and helped bring about democratic change in the Republic of Yugoslavia just this year.

At other times, we have had to reconcile differing views. I was in charge of negotiations with the EU and with Russia over investments in Iran under the Iran and Libya Sanctions Act of 1996. In that case, sanctions, if imposed, could have badly impaired diplomatic and economic relations. But by using the project-by-project waiver authority, which Congress wisely built into that act, we were able to gain agreement from the EU to strengthen controls on high-tech exports to Iran and to aggressively fight terrorism. The Russians agreed to adopt, for the first time, a catch-all export



control system. These actions, which directly furthered the basic goal of the Sanctions Act, would have been impossible without presidential waiver authority.

This authority was also the key to my two extended negotiations with the EU over sanctions on Cuba. The Helms-Burton Act of 1996 requires certain measures with respect to firms that invest in property that was confiscated by the Cuban government. The first negotiation, in 1997, resulted in the EU's taking a common position on Cuba that explicitly tied closer relations to that island to improvement in its record of protecting human rights and extending democracy. It cleared the way for a series of presidential waivers of sanctions under Title III of the Helms-Burton Act, which so far have been exercised every six months by President Clinton as the EU, for its part, has renewed and implemented its common position. In the second negotiation, in 1998, the EU acknowledged for the first time that Cuba had confiscated U.S. property in contravention of international law. It agreed to keep its member governments from officially supporting investments by EU companies in the illegally expropriated property and to refrain from giving export and investment subsidies to companies engaged in making such investments. This could be much more effective in restraining such investments than the provisions of Title IV of Helms-Burton, which deny U.S. entry visas to executives of such companies and their families.

However, implementation of this agreement is contingent on our obtaining waiver authority from the Congress under Title IV. The sanctions bill, which passed the last Congress, does restrict the president's ability to initiate certain new sanctions on agricultural and medical products and to maintain existing ones by requiring congressional approval of such actions. The Agricultural Appropriations Act of 2000 permits exports of U.S. farm and medical products to sanctions countries, including Cuba, but constrains the potential trade opportunities by barring our government and limiting U.S. private banks from providing financial assistance to facilitate such exports.

## RECOMMENDATIONS

I do not wish to overemphasize the amount of conflict in our trade with the EU. The vast bulk of our commerce is conflict-free. But given the hundreds of billions of dollars that flow between our two economies each year, friction is inevitable. Moreover, there are continuing good-faith efforts to solve the problems that exist, and some solid agreements have been produced. Last July, for example, the two sides negotiated what is known as the Safe Harbor agreement on privacy laws. The EU had been concerned that the privacy rights of its citizens might be compromised if U.S.-based firms were given access to the consumer data compiled by their European subsidiaries. It argued that privacy protections are not as rigorous on our side of the Atlantic. An example would be patient diagnosis and treatment information that guides research on new pharmaceuticals. U.S. industries argued that this information was necessary to their work and had been collected in compliance with EU regulations. Through negotiation, a compromise was reached allowing U.S. firms to access this data, provided that in using it they adhere to seven important principles that the EU has adopted designed to safeguard data about consumers.

An analysis of these disputes makes it clear that in operating under a rules-based system, states need to be more creative in how they solve the complex and difficult issues they encounter with their trading partners.

First, they should not bring disputes to the WTO that might be better resolved by other means. Tax matters such as FSC, for example, are more suitably handled in the Organization for Economic Cooperation and Development (OECD), which has already launched a useful effort to deal with harmful tax competition issues. Time and again, the OECD has proven itself to be the forum in which these issues can best be addressed.

Secondly, we must make use of existing bilateral and multilateral mechanisms to find an earlier solution to some of these problems. All too often, trade partners take actions that exacerbate tensions that could have been avoided by prior consultation. Our “early warning system” that is supposed to identify such problems before they become full-scale disputes needs to be expanded and improved. We should use the U.S.-EU summit process more effectively to resolve trade disputes that cross into other policy areas. We have already used such mechanisms to mitigate EU concerns over unilateral U.S.-EU sanctions and to try to diffuse tensions regarding trade in genetically modified organisms. The Safe Harbor agreement, discussed above, was reached at last July’s U.S.-EU summit.

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Thirdly, we need to involve the private sector to a greater degree in efforts to resolve trade issues. I worked with the late secretary of commerce Ron Brown to develop the Transatlantic Business Dialogue, which brings together both governments and private-sector CEOs to try to reduce obstacles to trade. It has helped to an unprecedented degree to set a common agenda between the EU and the United States. We should also make increased use of other groups such as the Transatlantic Environment, Consumer and Labor Dialogues.

Lastly, we need always to advocate the basic principles by which modern societies should conduct their economic relations: fair and transparent trade rules; respect for international commitments; the protection of core labor standards and the environment; and the reliance on scientific principles, not political considerations, as the basis for environmental, health, and safety decisions. More broadly, we must not lose sight of the overall economic and political relationship that the United States and the EU have worked so hard to build and that has provided such enormous benefits to our economies and our peoples in the past several decades.

Looking to the future, the United States and Europe will have to cooperate even more to strengthen their relationships with the developing world. The labor force in all our countries is aging, and our birth rates are comparatively low. Over the next 25

years, almost all of the world's population growth, as well as most of its productivity growth, will occur in the developing world. In the past, we were interested in development for humanitarian reasons, or to strengthen democratic institutions against foreign threats. It is now also a matter of cultivating customers for our goods and services.

The United States and Europe have made historic strides together. We still have a ways to go in our own relationship and in adjusting to the realities of the new global and demographic era. The continued success of our relationship will require political as well as economic leadership, cooperation and good will, diligent work, and hard bargaining. On a foundation of mutual respect and shared success, I am very hopeful we can meet the challenges that confront us both.