
Changing Terms of Trade: Managing the New Transatlantic Economy

I. The Transatlantic Economy

The economic relationship between the United States and the European Union (EU) is in the midst of a significant transition. In the past, the dominant element of that relationship was trade. This was only natural, given their large share of the global trading system: the United States generates 19 percent of world trade, and the European Union 20 percent. Moreover, the United States is the EU's largest trading partner, while the EU is the single largest importer into the United States and the second largest market for U.S. exports.¹ But in recent years, several new elements have become more prominent in the transatlantic economic relationship, bringing with them both challenges and opportunities.

- The level of mutual transatlantic investment has increased enormously. By 1999, the EU direct investment position in the United States totaled \$624 billion and the U.S. position in the EU had reached \$512 billion. Furthermore, the amount of direct investment stocks has doubled since the beginning of the 1990s.² As a result, the two economies are becoming ever more intertwined, and policy areas that were previously seen as “domestic” are now of direct concern to the other party.
- As both the United States and European Union move toward the new economy and cope with the implications of emerging technologies, these changes are also injecting new challenges into the transatlantic relationship. Specifically, developments in genetic engineering and information technologies associated with the internet have highlighted differing attitudes toward innovation and the accompanying risks, and emphasized contrasting views on the appropriate roles for the market and for government.
- A new emphasis has emerged on the importance of regulations and regulatory structures. Differences in regulations – and in how they are made and enforced – are key to much current and potential transatlantic discord. Even trade disputes are now more likely to be

¹ Figures are for 1998 trade in goods. International Monetary Fund, *Directions of Trade Yearbook* (Washington, DC: International Monetary Fund, 1999).

² “U.S. Direct Investment Abroad” and “Foreign Direct Investment in the United States,” *Survey of Current Business*, Bureau of Economic Analysis, U.S. Department of Commerce, September 2000. www.bea.doc.gov, viewed December 14, 2000.

focused on regulations rather than on tariffs and quotas. Moreover, these regulations often reflect distinctive cultural attitudes that are inherently difficult to reconcile.

- Along with these economic shifts has come an enhanced involvement of civil society groups in these issues. As the transatlantic economic relationship increasingly impinges on the domestic policy sphere, a wider range of people and institutions is being affected. The question of how to integrate them into the policy process in an appropriate and effective way will be a central issue on the transatlantic agenda in the coming years.³

Each shift is important, but especially when taken together, these changes have significant implications both for the U.S.-European relationship itself and for the role of the transatlantic partners in the wider international arena. For the United States and the European Union, the growth of investment and the emergence of new technologies offer potential for enhanced economic prosperity on both sides of the Atlantic. But given the tremendous stakes involved and the relatively few rules, the likelihood of U.S.-EU conflict over these issues is also considerable. The growing importance of regulatory regimes and the increased involvement of civil society groups, if not handled constructively, may accentuate differences even further. Beyond the transatlantic relationship, this transition in the U.S.-EU economy is a foretaste of the challenges that will soon face the international economy as a whole. The success or failure of the United States and the EU to deal effectively with such issues will establish a pattern likely to be repeated as the forces of globalization spread new technologies and industries around the world.

The new U.S. administration and its European partners face a formidable challenge. An effective response must be based on a recognition of the gains this transition may bring, but also an awareness of the disagreements that may arise. Thus, early in its tenure, the Bush administration should undertake a high-level reexamination of the transatlantic economic relationship. This might be led by the new U.S. Trade Representative, but it should involve very senior inter-agency participation from at least the Departments of State, Treasury, and Commerce, as well as the White House. The conclusions of this effort should be the basis for a serious and extensive discussion at the June 2001 U.S.-EU summit. This review should take into account the total scope of that interaction, its importance within the global economy, and its growing impact in the domestic arenas on both sides of the Atlantic. A first step will involve identifying and addressing potential disagreements not only in trade, but also in the areas of regulatory policy, mergers and acquisitions, and investment rules – issues that were formerly domestic concerns, but that are increasingly affected by the international economy.⁴ These issues are increasingly vital to the health of the transatlantic economic relationship, and the stakes involved in any serious dispute would be huge. But more important than trying to predict

³ Thomas M. T. Niles notes: “Integration of ‘civil society representatives’ into the process should take place at the U.S. government/European Commission level.”

⁴ With the development of the euro, monetary relations will undoubtedly become a much more important element of the transatlantic economic relationship in future years. However, given that the range of issues examined by the working group is already extensive and that a thorough examination of monetary issues would require significant additional expertise, it was decided to exclude monetary relations from the group’s consideration, except as they affected trade, investment, and other issues already included in the report.

specific disagreements – which, by their very nature, are unpredictable – the United States and the European Union must broaden and refocus their dialogue beyond trade issues to the totality of the economic relationship. Leaders in both Washington and Europe must help their constituents better understand the importance of that relationship at a time when the prosperity of each individual economy is increasingly affected by investments, mergers, regulations, and technical innovations around the world and particularly from across the Atlantic. The global economy is in the midst of a transformation and the transatlantic economy, with its high levels of interdependence, is at the forefront of that change.

This effort to refocus the transatlantic economic dialogue will not succeed, however, unless it is built on two strong foundation stones:

- a serious initiative to resolve several outstanding transatlantic trade disputes;
- the effective integration of civil society representatives into the policy dialogue.

At first glance, it may seem paradoxical to require the resolution of trade disputes in order to refocus a dialogue away from those same disputes. It is true that transatlantic trade disagreements have often commanded more attention than warranted, given the relatively small part of U.S.-EU economic interaction they represent. But enough disputes have lingered for long enough that they have polluted the atmosphere, stifling a productive discussion about the larger relationship. Highlighting the extent of the rest of the economic relationship puts the trade disputes in perspective, but also makes it more imperative that they be resolved.

As demonstrated by the controversies over hormone-fed beef and genetically modified organisms, representatives of civil society have come to play an increasingly important role in the transatlantic economy. Business and agricultural interests have long been involved in the U.S. - European policy dialogue, as have labor unions. But as environmental practices and health and safety standards have been attacked for restraining trade, other groups, especially consumer and environmental NGOs, have become active. Members of various European parliaments, as well as of the U.S. Congress, have expressed concerns raised by the range of non-governmental organizations. As elected representatives, many legislators feel themselves to be the most legitimate spokespersons for the concerns of civil society. As the global economy affects matters that were once reserved for domestic politics, and as new technologies, such as the internet, blur the lines between domestic and foreign, activism on behalf of civil society is likely to increase. Just as business, agriculture, and labor have long been part of the transatlantic policy dialogue, so the responsible representatives of these newer concerns must also be included.

The next few years will demonstrate whether the United States and Europe can manage this transition constructively, or whether the transatlantic economic relationship will be beset by continual disputes. For success to be achieved, Washington and Brussels must first acknowledge the magnitude of the transition in their economies and their economic relationship. They must address existing disputes and find ways to involve new constituencies in their dialogue. This will require that they significantly enhance their understanding of the complex framework within which each other works. Progress will not be made until Washington and Brussels have a better regard for the policy processes and domestic pressures that guide the decision making of the other.

But the United States and the European Union should also look beyond the immediate needs of their economic relationship. It is easy to focus solely on specific disputes to be settled or particular agreements to be negotiated. But real progress usually follows only from the identification of larger, more fundamental goals. Some ambitious proposals of the past, such as a transatlantic free trade area, may seem worth revisiting, even though significant obstacles remain. Ironically, the current stalemate over the start of a new WTO Round may offer some opportunities. The absence of a consensus on a Round may push the United States and the European Union to consider alternative ways of approaching various issues, including those that fall outside WTO jurisdiction. This in turn may encourage progress among other parties, and the reintegration of these issues into a multilateral framework. Whether this is the most appropriate path is unclear, but the United States and the EU must find some way to move the agenda forward.

Clearly, the United States and the European Union have a significant agenda in front of them. At the same time, the Bush administration has made clear the high priority it will give to furthering economic relations within the Western hemisphere. This commitment is long overdue and should be welcomed. But it should not lead to the neglect of the challenges facing the transatlantic relationship. In fact, the long-term success of the economy of the Western hemisphere will depend in part on whether the transatlantic economy successfully weathers its current transition. Continuing transatlantic disputes will inevitably distract from efforts to build a Free Trade Area of the Americas (FTAA) or other hemispheric initiatives. Moreover, the gains of an FTAA should be solidified through, and complemented by, a new multilateral Round; something that will require U.S.-EU consensus. Perhaps most important, the size of the transatlantic market inevitably ensures that the standards and practices agreed by Washington and Brussels greatly influence the standard operating procedures in other markets as well. As the United States and European Union develop approaches to emerging issues such as biotechnology and internet privacy, these will inevitably affect how those same issues are treated in the hemispheric market.

A focus on the U.S.-EU economy is also critical because of importance to the larger transatlantic political relationship. Ten years after the end of the Cold War, the U.S.-European alliance exists in a context of instability and continuing change. The demise of the Soviet Union removed the foundation of a bipolar international order, which has yet to be replaced. The United States has retained a preeminent position in terms of military capacity, but that has not guaranteed an orderly and secure world. Conflicts and humanitarian crises in the Balkans, the Persian Gulf, and Africa have led to military interventions, sometimes involving U.S. troops, sometimes European forces, and sometimes both. Within the transatlantic relationship itself, the Cold War balance of power is shifting, as the European Union seeks to play a larger role on the world stage. The eventual enlargement of the EU to twenty-some members and the possible development of a greater European military capacity will change the transatlantic relationship in ways that are still far from clear.

It is thus imperative that transatlantic economic interaction not be a continuing source of tension, but instead the basis of an effective partnership. The U.S.-EU economy will be one of a number of priorities to be addressed within the overall relationship, including NATO enlargement, the development of a European security and defense policy, U.S. consideration of a national missile defense, EU enlargement, and transatlantic cooperation and discord over a range of other international issues, such as climate change and the International Criminal

Court. Tensions over any one issue – and particularly over a key matter such as economics – will undoubtedly spill over to affect the tenor of the entire relationship. The current U.S.-EU institutional structure, based on the 1995 New Transatlantic Agenda, is derived from the immediate post-Cold War period and will require strengthening if it is to reflect this more comprehensive agenda. Even more important than updating institutions, the transatlantic relationship must find the political will needed to develop and maintain joint leadership on a range of global challenges. The economic relationship is a good place to start demonstrating that this is indeed possible.

Finally, the transition in the transatlantic economy must be well managed not only because of its impact on the United States and Europe, but also on the wider international arena. One of the few clear facts about the post-Cold War world is the growing impact of the phenomenon of globalization, as people, money, and ideas move through increasingly porous borders, eroding the distinction between international and domestic concerns. But this is not a predictable phenomenon: the extent of globalization, and even our understanding of what it means, changes with frequency. As was amply demonstrated at the WTO summit in Seattle, globalization has generated new fissures within as well as between countries. There are now more actors with a stake in the system, but a less definitive hierarchy for resolving disputes. Few international institutions or governments have yet been successful in managing the competing demands of this process.

Like most other countries, the United States and the EU have been buffeted by globalization. The changes in their economic system demonstrate the extent to which their borders have become porous and their policies subject to pressures from social and economic forces around the world. Thus, the United States and the EU may serve as both model and pathfinder for the rest of the world, and their successes and failures in coping with the challenges of their intertwined economies will provide invaluable lessons for others. More importantly, their future role in the global economy will depend on their success at managing this transition. If growing mutual investment and the emergence of new technologies contribute to a strengthened transatlantic economic relationship, rather than more frequent instances of conflict, the United States and EU will be better able to reach out constructively to the developing countries and others in the continuing debate over the shape of the global economy.

Under these circumstances, the need for effective leadership in the international economic system is acute. The United States and the European Union are obvious candidates to play key roles as leaders of the international economic system. First, they represent the two biggest economies in the world, with a combined GDP of almost \$17 trillion, or just over 50 percent of the world total. Their combined international trade activity represents just over 40 percent of all exports and just under 40 percent of all imports, and their share of world investment is comparable. Second, since the 1950s, the United States and Europe have exercised *de facto* leadership of the international economic system. They play leading roles in such institutions as the World Bank and the IMF. And, as the history of past multilateral trade negotiations demonstrates, no general agreement has been possible unless a transatlantic accord has been reached. Clearly, they are not alone as leaders in the international economy; Japan and the other OECD countries are also significant players. But the reality is that transatlantic cooperation has been key to building global stability and prosperity.

But that cooperation is no longer assured. The failure to launch a new trade Round in Seattle was a clear indication of the enormity of the challenges facing transatlantic leadership. The substantive divide between the developed and developing countries has, if anything, grown wider. The divisions within countries, including both the United States and Europe, has made governments increasingly reluctant to make the hard decisions needed to move the international economic agenda forward. Without adequate preparations, both within and among countries, there is little chance that multilateral economic negotiations will be productive. What is needed is a new type of leadership that can begin to bridge the divides between civil society and government and between developed and developing countries.

It is not at all clear that the United States and Europe can secure that mantle of leadership, either shared or individually. Although the United States and EU certainly retain their dominant position in the world economy, there are also changes that may spur rivalry rather than cooperation. Perhaps most obviously, without the Soviet threat, there is less pressure for unity between Europe and the United States, and thus more opportunity to disagree. Tension may also arise from the shifting approaches to international engagement: at a time when the United States has been reluctant to engage in several multilateral efforts, the EU may assume a larger role in the world, not just economically, but politically as well. Other developments – including the enlargement of the EU and the potential emergence of the euro as an international currency – may offer new opportunities for rivalry and misunderstanding.

Even if all the consequences of these changes are still far from clear, these shifts will certainly complicate efforts by Washington and Brussels to manage their economic relationship. The increasing integration of the US and European economies will bring more frequent interaction and more chances for conflict, along with higher stakes when disputes arise. Given the changes in the larger transatlantic relationship, it will be especially important to keep these disagreements over economic issues within acceptable bounds. The focus should be on the potential for growth and prosperity, as well on the need for leadership in the global economy. Thus, even before considering how to manage the transition in the transatlantic economy, an essential first step will be to address those persistent disagreements that erode U.S. - European trust and cooperation and to develop effective means of dispute resolution.

II. Disputes and Dispute Resolution

In recent years, the transatlantic economic relationship has been troubled by a series of persistent, often acrimonious trade disputes. Despite the fact that they represent a very small portion of the overall value of U.S.-EU commerce, they have received an enormous amount of attention and are widely viewed as posing a threat to the health of the overall transatlantic relationship. The nature of those disputes and the reasons behind the failure to resolve them says much about the U.S.-EU economic relationship and how it is changing. It also clearly demonstrates the limitations of the existing dispute resolution process. The major outstanding disputes are the following:

Bananas – In 1998, the United States won a WTO case in which the rules for importing bananas into the EU were declared too restrictive and thus illegal. Negotiations to revise those rules have not succeeded, and in March 2000, Washington declared its intention to impose retaliatory sanctions worth \$191 million.

Beef hormones – Also in 1998, the WTO ruled against an EU ban on the importation of animals (both live and processed) that been treated with growth hormones. Transatlantic negotiations on lifting the ban have not succeeded, and the WTO has given the United States permission to impose sanctions in compensation for \$117 million worth of injury.

Foreign Sales Corporation (FSC) – In February 2000, the WTO ruled in favor of the EU's contention that the FSC constituted an illegal export subsidy since it allowed U.S. firms to avoid paying taxes on some overseas sales. In the face of European threats to seek retaliatory sanctions, the United States revised the law governing the FSC. Brussels warned that the changes in U.S. legislation are inadequate and has requested that the WTO authorize sanctions worth just over \$4 billion. Both parties are waiting for a WTO ruling on the revised U.S. legislation.

Airbus – In 1992, recognizing the need to promote a more favorable environment for international trade in large civil aircraft and to reduce trade tensions in the area, the United States and the EU signed an agreement to introduce greater disciplines on support for the development and production of these programs. Since that time there has been disagreement over how the United States and the EU support their respective aerospace industries. With the launch of the Airbus A380 super-jumbo jet, the United States has warned the EU that any financing for the project should be on commercial terms or it will face serious repercussions. The EU has indicated that if Washington should file a dispute case in the WTO, Brussels is prepared to launch a parallel suit based on U.S. support for Boeing.

Genetically modified organisms (GMOs) – In 1998, the European Union introduced a moratorium on approvals of GMOs, effectively banning the importation of new GMO-based products, including some U.S. grains and other foodstuffs (the EU had previously approved 18 GMOs which can enter the EU). The U.S. has proposed developing a GM-free certification process, but the political sensitivity of this issue among the European public has made any resolution difficult. In July 2000, the European Commission launched an effort to resume approvals of GMOs, in particular the 14 pending requests. Although the outcome is still uncertain, that effort and recent transatlantic negotiations on GMOs have prevented the dispute

from escalating. Whether this is an indication that both sides have recognized the high stakes involved and are working toward a solution, or whether it is simply the calm before a truly major transatlantic storm, is not yet clear. In any event, this issue is seen as a future indicator for how well the established dispute settlement mechanisms might cope with fundamental transatlantic differences over new technologies. The dispute has not been taken to the WTO.

Two other long-standing but currently quiescent disputes could also easily disrupt transatlantic relations:

- **Agriculture** has been a focus of U.S.-EU disagreement for many years. The 1994 Uruguay Round accord included the first real agreement to reduce subsidies on farm products. It also included the so-called peace clause, which exempted the EU's Common Agricultural Policy (CAP) from WTO cases until the end of 2003. Despite the failure to start a new WTO Round in Seattle, negotiations over farm trade are underway, although there is clearly still disagreement over several issues, including the types of payments that qualify as a subsidy. Without a final agreement – which is unlikely to be reached in the absence of a new Round – the potential for conflict remains high.
- A major U.S.-EU controversy over **sanctions** was temporarily resolved in May 1998 when waivers were granted to some European firms investing in Cuba and Iran. However, the relevant parts of the Helms-Burton and the Iran-Libya Sanctions acts have remained U.S. law, leaving European firms potentially subject to extraterritorial sanctions should those waivers be withdrawn. The 1998 agreement was intended to be effective through the end of the Clinton administration. An attempt to revisit the bargain by either the Bush administration or the Europeans could quickly escalate into a major transatlantic conflict.

The importance of these persistent disputes should not be overemphasized, for they represent a fairly limited portion of U.S.-EU economic interaction. But they do demonstrate the difficulties involved in settling disputes. Indeed, one of the few prominent transatlantic disagreements to be resolved in recent years was that concerned with data collection and privacy, the so-called “safe harbor” agreement. In this case, an EU directive mandating certain standards for data protection would have limited the transfer of such data to U.S. companies. After two years of negotiation, Washington and Brussels agreed to a set of voluntary standards that U.S. companies could adopt and thus be able to receive data transferred from the EU.

These issues also demonstrate the changing nature of the transatlantic economic relationship. It is not simply a matter of increased trade volume, but of a qualitative shift in the type of interaction. Specifically, they highlight two important aspects of U.S.-EU commerce, both of which are likely to intensify further in the coming years.

- Disputes are no longer primarily about traditional trade issues such as denying market access through quotas or tariffs, but increasingly about national regulations and other behind-the-border issues. In most cases, one side claims that the other uses regulations to restrict market access or acquire a trading advantage. In short, regulatory structures that once were viewed as purely domestic are now central to transatlantic disputes and their resolution.
- Disputes have an increasingly overt political component, and their outcome is no longer governed simply by economic and legal factors. This should not be a surprise: as transatlantic commerce affects domestic structures and regulations, it will increasingly attract

the attention of domestic political interests. Moreover, in this era of globalization, there is an increasing concern that commerce may have serious impacts in other areas, including protection of the environment and the transfer of new technologies. Both the beef hormone and GMO cases have become high profile issues in European domestic politics.

Given that transatlantic commerce has intruded so far into the domestic arena, and in some cases become such a political lightning rod, disputes will continue to arise. Of course, one case cited above – that of privacy and the safe harbor accord – does offer hope that disagreements can be resolved. Unfortunately, it also demonstrates the very favorable circumstances that are required; negotiations began almost two years before implementation of the EU directive, and there were few economic or political stakeholders yet involved who might have complicated U.S.-EU talks. The fact that these conditions are rarely met – indeed, usually circumstances are the opposite by the time negotiations begin – points up the need for an effective dispute resolution procedure.

Unfortunately, the existing mechanisms for addressing trade conflicts have been shown to be inadequate in such politically charged cases. In 1995, the succession of the GATT by the WTO, with its stronger dispute settlement understanding, was expected to lead to the settlement of disagreements in a speedier and less conflictual manner. Although the WTO process has been effective in many cases, it has not been very successful in these high-profile, politically sensitive transatlantic squabbles. In fact, in some cases, the WTO process may even have made a dispute less amenable to a negotiated settlement. By the time a case has gone through a WTO panel and perhaps an appeal, stakeholders on both sides have become solidified around their positions, making compromise more difficult. In addition, the aspect of the WTO dispute settlement process that was thought to be most important – that rulings could be enforced through sanctions – has not proven to be effective in difficult, politically sensitive cases. Sanctions have been useful in implementing some WTO rulings, especially those involving less evenly matched parties. But in the large transatlantic economies, such sanctions tend to be less punitive, making resistance less politically costly. Moreover, the U.S. experience in identifying sanctions in the beef hormone and banana cases illustrates the difficulties involved in imposing sanctions so they do not adversely affect one's own economic interests.⁵ In short, the use of the WTO process in some of the most politically sensitive transatlantic cases has some serious shortcomings.

In response, there has been growing debate about reforming the WTO dispute settlement process. Some changes would undoubtedly be beneficial, especially in enhancing transparency throughout the dispute settlement process. It may also be useful to allow those given the right to impose sanctions by a WTO panel to seek to negotiate compensatory arrangements with the other party. However, it should be remembered that the WTO has worked well in many cases. For that reason, significant reform of the process would probably be unwise. That the WTO has been less effective in a limited number of high profile cases, indicates that the fault lies not so much with the process itself, but with a misjudgment about the capabilities of that organization to impose a settlement when the parties lack the political will to resolve the issue.

⁵ The so-called carousel sanctions potentially exacerbate this dilemma by requiring USTR to target a new group of goods every six months.

Instead of focusing solely on the shortcomings of the WTO, the United States and the EU should recommit themselves to finding a solution to their bilateral disagreements. This will require not only political flexibility, but also leadership aimed at developing the domestic mandate required to achieve the necessary compromises. This effort should be addressed in two parts. As a first step, Washington and Brussels must undertake a serious, concerted effort to resolve the current persistent disputes, especially those over beef hormones, bananas, FSC, and perhaps GMOs. This effort should be conducted at the highest possible political level. The U.S. trade representative and EU commissioner for trade will undoubtedly be central to the negotiations, but, just as in the final stages of a multilateral trade round, the president and top European leaders must be engaged if a final agreement is to be reached. The politically sensitive nature of these disputes should be acknowledged from the beginning, and those involved should recognize that compromises will have to be made by both sides. Combining several disputes may create opportunities for balancing concessions and gains, although clearly some domestic interests will be hurt (or, at least, will not gain all they had hoped). Thus, along side the transatlantic negotiations, each party should work to create a domestic consensus in support of this effort. It will be necessary, for example, to convince members of Congress and various parliaments to look beyond the concerns of specific interest groups and focus on the importance to the overall relationship of having these disputes resolved. Real leadership will be required. If these persistent disputes are to be prevented from doing further harm to the U.S.-European relationship, there should be no further delays.

Once the current disputes are moving toward some resolution, the U.S. and EU should embark on the second part of this effort: developing better ways to cope with difficult cases in general. With the limitations of the WTO now recognized, it is clear that Washington and Brussels will be increasingly cautious about sending politically sensitive cases to that dispute settlement procedure. Instead, they will need to develop an alternative that is grounded in an understanding of the growing political sensitivity of these issues. First, the existing early warning system should be strengthened so that potential disagreements can be identified early, as in the privacy case.⁶ It may be advisable to impose a mandatory pause for discussion and negotiation. An enhanced early warning effort should also take into account the fact that transatlantic disputes can arise not only from domestic regulatory measures, but also from legislative initiatives. Second, once potential disputes are identified, USTR should conduct an assessment of the economic damage that may ensue if no settlement is reached. This is the only way responsibly to judge whether a dispute is worth pursuing and may also help ensure that cases backed by special interests (as most are) are not escalated beyond their economic merit. If, however, the damage assessment reveals a large financial cost, it might help both parties focus early in the process. Third, there is a need for an alternative, less juridical mechanism that would allow greater negotiating flexibility. Not every case is suitable for the WTO, particularly

⁶ Because the existing transatlantic early warning system was established only recently, at the June 1999 U.S.-EU summit in Bonn, it is too early to conduct a definitive assessment. The existing mechanism calls for the identification of potential conflicts on a wide range of economic and political issues and their submission to the Transatlantic Economic Partnership Steering Group or the New Transatlantic Agenda Task Force, which will be responsible for follow-up. The issues will be reviewed prior to each U.S.-EU summit to determine if any topics should be discussed at that meeting. The NTA dialogues are invited to identify problematic issues and propose possible resolutions. "Early Warning and Problem Prevention: Principles and Mechanisms," U.S.-EU Summit, Bonn, June 21, 1999.

those that touch on genuine political interests. Thus, the United States and the EU should explore dispute settlement processes based more on mediation, albeit with some kind of compliance commitment. This process could serve either as a preliminary step to WTO adjudication or, by mutual agreement, as a substitute.

Conclusions

- 1) Although the WTO dispute settlement process has handled many cases effectively, its use in politically sensitive transatlantic cases has serious limitations.
- 2) Retaliatory sanctions as a means of enforcing WTO judgments have generally not proven effective in U.S.-EU disputes.
- 3) Early identification of potential disputes can be helpful in avoiding or ameliorating differences, but it is also too easy to ignore early warning in its current form.
- 4) Certain transatlantic disputes have persisted precisely because they are politically sensitive; any new mechanism for addressing these disputes must take that sensitivity into account and offer appropriate flexibility.

Recommendations

- 1) The Bush administration and the European Union should launch a high-level initiative to resolve the current outstanding disputes in a comprehensive framework. This will involve bilateral negotiations across a range of issues and a focused leadership effort by each party to develop the necessary domestic consensus.
 - 2) The new U.S. administration should work with the EU to construct a bilateral strategy for addressing sensitive future disputes. In particular, they should:
 - a) strengthen the early warning mechanism;
 - b) prepare damage assessments prior to seeking redress; and
 - c) develop a bilateral mediation process that could be used either as a preliminary step before submission of a dispute to the WTO or as an alternative. That process should include some form of compliance commitment.
 - 3) The next WTO round should examine the dispute settlement mechanism for possible improvements, but should focus on fine-tuning rather than radical changes.
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III. Investment and Competition Policy

One of the most striking developments in the transatlantic economy in recent years has been the growth in mutual investment. In 1994, bilateral flows of foreign direct investment (EU flows into the United States, plus U.S. flows to the EU) totaled just over \$50 billion.⁷ In 1997, they reached \$109 billion, and in 1999, that figure escalated rapidly to \$286 billion.⁸ As a consequence of these high levels of investment, more European and U.S. firms are more directly involved than ever in each other's economy, dealing directly with regulatory policy, labor relations, and interest groups. This has reinforced the trends noted above: the growing importance of national regulatory structures in transatlantic economic relations, and the enhanced domestic political implications of that interaction. Thus, the rapidly growing level of mutual investment is a key factor in the qualitative transition underway in the U.S.-EU economy.

Such enhanced economic interaction brings with it the opportunity for growth, but also the potential for increased conflict and more frequent disputes. The growth in transatlantic investment has focused attention on this issue, but on the whole the current situation is rather benign. There are, however, several factors that give cause for concern in the future.

1) Structural reforms have been adopted at a different pace and in different ways within the U.S. and EU economies. There is a wide consensus that the transatlantic economies are moving in the same direction, but that the EU is lagging behind. The differing levels of performance seem based, at least in part, on contrasting approaches to the role of the market. The United States has long embraced the free market in most areas, and U.S. policymakers generally prefer to let problems that arise be addressed through the market, if possible. In Europe, however, there has been considerable reluctance to abandon the traditional, more state-oriented approach, or to forgo reliance on regulations to ameliorate the impact of the market. This is not only a matter of labor unions and social welfare groups resisting liberalizing, market-oriented reforms, but also opposition from business groups that find the established practices comfortable. Indeed, the differing U.S. and EU approaches to the role of the market are in turn deeply rooted in distinct social and cultural foundations. In general, U.S. society places a premium on self-reliance and practicality, thus providing a firm base for a market-driven economy but few guarantees for those who do not prosper. European social norms, on the other hand, stress the role of government and social institutions in protecting citizens and ensuring that certain fundamental needs are met. Some European governments have recently moved toward the more market-driven U.S. approach, but how that will affect the European economy is still unclear.

⁷ This figure is based on EU(12); if Austria, Finland, and Sweden are added, the total is just over \$55 billion. "U.S. Direct Investment Abroad: Capital Outflows, 1994," and "Foreign Direct Investment in the United States: Capital Inflows, 1994," Bureau of Economic Analysis, U.S. Department of Commerce. Viewed at www.bea.doc.gov, December 13, 2000.

⁸ Bureau of Economic Analysis, U.S. Department of Commerce. Viewed at www.bea.doc.gov, December 13, 2000.

Transatlantic investment has been particularly affected by the slow reform of European capital markets. Traditionally, banks have dominated these markets and have focused their lending on firms where they have established relationships, making it difficult for new firms to acquire the necessary capital. There are indicators of change, including a new German tax law that will encourage corporations to sell subsidiaries or shares in other companies. The development of European monetary union and an influx of private investment capital from the U.S. are also likely to stimulate reforms, but there is still a long way to go.

2) Since 1995, the direction of transatlantic investment has not been in balance, as significantly more EU capital has flowed toward the United States than U.S. funds to Europe. In 1998, for example, \$153 billion went from the EU to the U.S., while only \$82 billion traveled in the other direction; in 1999, the imbalance was even greater, with \$228 billion in EU funds entering the U.S., and only \$58 billion traveling in the other direction.⁹ A similar pattern can be seen in the acquisition of firms: in 1999, Europeans spent just over \$200 billion on U.S. firms, while U.S. firms spent almost \$90 billion for European companies.¹⁰ This imbalance is ascribed in part to advantages that European firms may enjoy in terms of a protected home market and ample cash reserves from past government subsidization. Such firms do not need to focus on shoring up their domestic market and have readily available funds for investment. But the imbalance also clearly results from plain economic common sense: the stronger U.S. economy has provided a very attractive investment climate, and European corporations want to be part of that. Until recently, the strong U.S. dollar has been more attractive to capital than has the weaker euro. In fact, European investment in the United States has helped balance the growing U.S. trade deficit with the EU.

3) Investment policy brings into play new sets of institutions and interests, creating more opportunities for internal conflict. In this regard, it is not simply an extension of trade policy. Within the EU, for example, the European Commission has a clear mandate for negotiating and enforcing external trade policy. Jurisdiction over investment policy is still largely held by the member states, thus opening the door to intra-EU competency arguments. Similarly, in the United States, a number of the policies and incentives affecting foreign investment are controlled by the states, not Washington. And, while trade policy in Washington is handled by the USTR and the departments of State and Commerce, the jurisdictional authority for investment is much less clear. As the political sensitivities associated with investment increase, other political institutions may also become more active. In 2000, for example, Senator Ernest Hollings (D-SC) introduced legislation that would prevent companies with more than 25 percent government ownership from acquiring U.S. telecommunications firms; a move that threatened Deutsche Telekom's proposed purchase of VoiceStream.

Even if these concerns did not exist, the sheer size of U.S.-EU investment, coupled with its recent growth, is significant enough to raise the question of whether a more formal transatlantic investment regime is desirable. Such a regime may appear even more desirable if a downturn in the U.S. economy leads more U.S. firms to invest in Europe. Given the slower

⁹ Bureau of Economic Analysis, U.S. Department of Commerce, viewed at www.bea.doc.gov, on December 13, 2000.

¹⁰ Juliana Ratner, "Europeans Enjoy US Shopping Spree," *Financial Times*, August 16, 2000.

pace of structural reform in the EU, these U.S. concerns may face unequal access to capital or practices that favor EU-based corporations. In this situation, the potential for serious transatlantic conflict would be high. Given the stakes involved, it makes sense to consider whether an investment regime is needed before a crisis erupts.

At the moment, however, there is very little political support for such a regime on a global basis. Since the failure of the OECD negotiations on a Multilateral Agreement on Investment (MAI), most governments have sought to avoid any similar efforts. Given the polarization between civil society and governments and between developed and developing countries on issues that would inevitably be addressed in such negotiations, there seems little prospect of success for a comprehensive investment accord. The EU is currently advocating inclusion of both investment and competition in the next WTO Round, but its proposals have become much less ambitious in the face of developing country opposition. U.S. policymakers are decidedly lukewarm toward the idea of putting investment and competition policy into the WTO, expecting that it would only exacerbate tensions between developed and developing countries. Among U.S. observers, the EU effort is regarded largely as an attempt by the Commission to gain more influence vis-à-vis the member states in this policy area.

But given the rapid escalation of transatlantic investment, it is time for an on-going discussion about that investment, including its benefits and potential difficulties, to be a top priority for the new U.S. administration and European leaders. In particular, they should closely consider the possibility of a bilateral investment initiative to be negotiated between the United States and the members of the European Union. Some may counter that the MAI foundered in part because of serious transatlantic differences and that a bilateral accord would likely meet the same fate. Moreover, the growth of investment in the last two years demonstrates that no regime is necessary to promote additional investment across the Atlantic. Instead, this initiative, which would be much more limited in scope than the MAI, might focus on a few measures. In particular, it might create a mechanism and guidelines for dispute resolution (including both state-to-state disagreements and investor-to-state); improve transparency on investment incentives; and encourage the extension of national treatment of investors across more sectors.¹¹ The negotiations should also provide an appropriate opportunity to build on the progress of the May 1998 U.S.-EU summit in reaching a compromise over the application of sanctions to inhibit investment in expropriated properties.¹² There is no doubt that reaching even a bilateral investment accord will be difficult. But even the process of discussions may advance understanding and help identify specific areas of agreement. With effort and time, a bilateral investment accord could eventually become the basis for a limited multilateral understanding.

¹¹ For an extensive discussion of transatlantic differences during the MAI talks and options for a new investment accord, see Edward M. Graham, *Fighting the Wrong Enemy: Antiglobal Activists and Multinational Enterprises* (Washington, DC: Institute for International Economics, 2000).

¹² In May 1998, the United States and the EU signed the "Understanding with Respect to Disciplines for the Strengthening of Investment Protection," in which they pledged to deny government commercial assistance and other support to companies investing in illegally expropriated properties. The agreement also specified a review procedure for investments in countries deemed to have a record of repeated expropriations. The Understanding is to become effective following congressional approval of a waiver to Title IV of the Libertad (Helms-Burton) Act, which has not yet happened. The Understanding was to form the basis of a joint proposal to the MAI negotiations.

The issue of investment is closely linked to that of U.S.-EU cooperation in competition policy. In recent years, a series of high-profile cases has demonstrated the growing importance of anti-trust regulation in the transatlantic economy. In 1997, for example, the European Commission threatened to block the merger of Boeing and McDonnell-Douglas, two U.S. companies with a significant share of the EU market (an agreement was eventually reached that allowed the merger to proceed). More recently, the merger of WorldCom and Sprint was abandoned in the face of opposition by both the European Commission competition directorate and the U.S. Department of Justice's anti-trust division. In October 2000, the European Commission approved the merger between Time Warner and America Online only after Time Warner dropped its bid for the music company EMI.

For the most part, the handling of these cases has been viewed as a significant example of transatlantic cooperation. The U.S. Justice Department and the Commission's competition directorate have worked closely together, largely on the basis of a rather limited agreement to request cooperation from the other in cases of anti-competitive practices, rather than seeking to apply laws extraterritorially. This cooperation has been effective in part because U.S. and EU anti-trust policies have been similar in recent years. As with investment, there has been some discussion of a multilateral regime. But other than an EU proposal to include such discussions in the next WTO Round, there has been little movement in that direction. Still, concern exists that the current transatlantic cooperation may not last, especially if there is a shift in anti-trust policy in either Washington or Brussels. For that reason, the new U.S. administration should consider ways to further deepen collaboration between U.S. and EU anti-trust authorities. It has been suggested that efforts to establish shared best practices to guide the review of mergers, as well as working toward enhanced transparency in the review process may be helpful in preserving and perhaps deepening transatlantic cooperation on competition.¹³ This may include harmonization of timelines for reviewing mergers and establishing similar requirements for data provision. Perhaps most important, Washington and Brussels should establish some agreed parameters for identifying those cases that should be reviewed, and by whom, and those that should not. Eventually, with more experience in the bilateral arena, it may be possible to establish multilateral guidelines, but the immediate priority should be to build on the existing transatlantic pattern of cooperation.

Conclusions

- 1) Investment and competition policy will be increasingly important in the transatlantic economic relationship and already deserve considerably more focused government attention as possible sources of transatlantic discord than they have recently received.

¹³ Some of these suggestions come from the report of the International Competition Policy Advisory Committee, established by the Justice Department. Co-chaired by Paula Stern and James Rill, ICPC issued a report (available at www.usdoj.gov/atr/icpac/finalreport.htm) in 2000 arguing for a Global Competition Initiative involving a forum for multilateral discussion of competition issues. Then U.S. Assistant Attorney General Joel I. Klein, in charge of the Justice Department's Anti-Trust Division, adopted some of these ideas when he spoke in support of a Global Competition Initiative before leaving office. Joel I. Klein, *Time for a Global Competition Initiative?*, speech delivered at the EC Merger Control 10th Anniversary Conference, September 14, 2000. www.usdoj.gov/atr/public/speeches/6486.htm (viewed Nov. 6, 2000).

- 2) There is little likelihood that a comprehensive multilateral investment or competition accord will be negotiated in the near future, either in the WTO or elsewhere.
- 3) Given the rapid growth of transatlantic investment, and the high stakes if serious disputes or differences of policy approaches were to arise, the United States and the EU have a strong interest in creating an environment and appropriate mechanisms that will help ameliorate or resolve conflicts over investment issues.
- 4) The current system of transatlantic cooperation on competition policy is working well, but may be disrupted if anti-trust policies on either side of the Atlantic should shift.

Recommendations

- 1) The new U.S. administration should focus on bilateral discussions with the EU on investment issues and closely examine the possibility of a bilateral investment accord. Such an accord would be limited in scope, at least initially, with an emphasis on dispute resolution, transparency on investment incentives, and national treatment. Eventually, such a bilateral accord may ultimately be extended into multilateral discussions.
 - 2) The new administration should also explore ways of reinforcing the current transatlantic cooperation on anti-trust policy. This may involve a modest bilateral arrangement that would establish clearer guidance as to which cases will be reviewed and address some technical aspects of competition policy, such as timing of reviews and data provision. As with a transatlantic investment accord, any agreements on competition policy might also be introduced into an appropriate multilateral forum.
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IV. New Technologies and Industries

An integral part of the transition in the transatlantic economy has been the emergence of new technologies and associated industries. New technologies are at the core of several persistent trade disputes, including those over beef hormones and GMOs. New industries, such as internet commerce, are challenging regulatory regimes that were written before those industries were even imagined. And the creation of new companies and industries has contributed to the boom in transatlantic investment.

But, like any key element in a process of change, these emerging technologies have considerable potential for generating transatlantic conflict. Even simply identifying those points of possible conflict – not to mention resolving them – has proven extremely difficult. In part that is because of the wide range of emerging issues, including commercial espionage, banking regulations, intellectual property rights on digital media, and privacy (the safe harbor accord is widely viewed as a first step toward resolution of this issue, not as a comprehensive settlement). In addition, the implications of a dispute involving these new industries, including whose interests are likely to be affected and how, are very difficult to determine until an actual disagreement has arisen. At that point, political sensitivities are aroused and any resolution becomes much more difficult. These points are well demonstrated by a closer look at two new issues that are likely to have a dominant place in the transatlantic economic agenda during the next three to five years.

E-Commerce has come to the fore largely because of a dispute over taxation of sales over the internet. The United States has maintained that taxes on items delivered over the internet should be no higher than if the item was purchased via traditional means (*i.e.* mail order catalogues, etc.). In most cases, sales taxes are only paid if the purchaser is located in a state where the seller has a physical presence. However, the EU and its members rely on value-added taxes on sales for a major part of their revenues and cannot easily contemplate exempting a growth area of the economy. If U.S. companies selling to Europeans are not liable for VAT, they will have a significant advantage over EU firms. There are suggestions in the United States that more internet sales will eventually be subject to some type of sales tax in order to protect states' revenues, but there is not yet a political consensus for doing this. Thus, at the current time, a resolution would seem to require an accommodation between the two different systems of taxation.¹⁴ Clearly, the financial stakes involved in this issue are huge for the businesses, governments, and consumers. In addition to the taxation issue, the United States and the EU have taken very different positions on whether goods delivered via the internet (software downloaded from a website, or a movie distributed over the internet, for example) should be treated as a good or service. U.S. companies have generally argued that these are no different from the original good (only the method of delivery differs); in other words, that WTO classification of goods and services should be technology neutral. The EU has argued that such goods are in fact services. Apart from being taxed differently, goods and services are often

¹⁴ In January 2001, the OECD committee on fiscal affairs agreed that a company was not necessarily liable to taxation in the country from which its website was accessed. Instead, a company would generally pay tax to the country in which its server is located, providing the server is performing a core business activity (not just acting as a conduit for information). *Financial Times*, January 10, 2001.

subject to very different import rules and restrictions. These issues are probably only the tip of the e-commerce iceberg, and their resolution may establish precedents for many as yet unforeseen e-commerce developments.

It appeared that the issue of transatlantic internet privacy had been resolved by the safe harbor accord of 2000. However, European data protection authorities have called into question the application of the accord to U.S.-based websites and U.S. companies have been slow to join safe harbor. At the same time, the U.S. Congress is moving toward further U.S. privacy legislation that has the potential for generating more conflict with European standards.

Biotechnology, like e-commerce, is a rapidly changing field with the potential for tremendous financial gain, and thus likely to have huge stakes at risk in any dispute. The current dispute over GMOs in foodstuffs (primarily grains) is only a small indication of the scope of biotechnological research that could eventually appear on the transatlantic agenda. Just as with e-commerce, biotechnology has the ability to challenge regulatory regimes on both sides of the Atlantic. But there is a major difference between new economy issues and the biotechnology sector: because the stakes in biotechnology are not just concerned with economic profits, but with environmental issues and human health, and in some cases include genuine moral dilemmas, biotechnology is regarded as much more politically sensitive. And within this politically charged atmosphere, biotechnology must maintain consumer confidence if it is to prosper as an emerging industry.

These two examples make clear that new technologies have the potential to raise seemingly fundamental differences between the United States and the European Union. In particular, observers often note that transatlantic differences seem especially striking in two areas:

- When confronted with the dilemmas inherent in any new technology, the EU (and most European governments) is likely to rely on regulation, while the United States is more likely to let the market sort matters out, using regulation only if and when market forces have failed to curb some harmful excesses.
- Thus far in the biotechnology area, and especially in matters of human health and safety, Europeans have for various reasons shown themselves to be significantly more risk-averse than U.S. citizens, who have been more willing to put their trust in a credible regulatory process and prepared to accept products that are reasonably (but not totally) assured of not causing harm.

Given these fundamental differences, it might seem that finding any middle ground on issues such as e-commerce or biotechnology would be impossible. If that is the case, transatlantic economic relations may be doomed to constant, irreconcilable conflict. Upon closer examination, however, the differences may not be so great as they initially appear. In particular, constant changes in attitudes and politics on both sides of the Atlantic have introduced some mitigating factors:

- The regulatory context for these new technologies and industries is shifting rapidly in both the EU and the United States. To add to the complexity, government policies are still under development and subject to change. In some cases, it is not even clear whether jurisdiction over these issues rests with Washington or the states, or with the EU or its member

governments. On the e-commerce taxation case, for example, a number of states in the U.S. are attempting to devise a simplified tax regime for internet sales; if successful, this would have a significant impact on Washington's position on this issue. The regulatory environments on these new issues in both the United States and the EU will continue to evolve.

- In reality, public attitudes in both the U.S. and EU are more flexible on health and safety issues than is usually portrayed in the press. While European caution on foodstuffs containing GMOs seems very firm, the same public has accepted pharmaceuticals and other medicines not approved in the United States. To some degree, European resistance to biotech foods can be ascribed to the lack of an effective food and medicine safety regime, particularly in the wake of several developments, including mad cow disease and AIDS-tainted blood samples. The establishment of a credible European counterpart to the U.S. Food and Drug Administration may help restore some consumer confidence and thereby contribute to a moderation of European views.¹⁵ In the United States, there is no doubt that the transatlantic dispute over GMOs has heightened sensitivities on this issue and that the U.S. public is adopting a greater degree of skepticism. Whether that skepticism will ever develop into the strong opposition of the European public is still very unclear. But to see one society as systematically risk-averse and the other as risk-tolerant ignores many of the complexities involved.
- Consumerism is a force of growing importance. Consumers seem less concerned than in the past with the national origin of a particular good, but instead base their purchasing decisions on whether the product meets their own needs. As a result, consumers are less likely to differentiate between European and U.S. firms (the pace of mergers and acquisitions has also made this distinction more difficult, particularly in terms of public perception). In addition, consumer confidence is of increasing importance in the new economy, as firms must demonstrate to consumers that their concerns in terms of privacy, safety, and other factors are being addressed. This is not simply a matter of altruism: a sudden loss of consumer confidence in an internet company or a food product can cause a massive drop in profit margins. In the final analysis, therefore, it is not the governments that will determine what is legal, but the public that will determine what is acceptable.

Even with these mitigating factors, finding solutions to disputes involving these new technologies will remain extremely difficult. With time, and given the constant evolution in attitudes and regulations, some potential disputes may simply fade away. But most will not, and some way will have to be found to moderate them, if not actually resolve them. Unfortunately, existing institutions have proven inadequate to deal with the disputes that have arisen. The continued unwillingness of the EU to implement the WTO finding in the beef hormone case demonstrates the weakness of an international legal regime when an issue is so deeply embroiled in domestic politics.

There have been some steps to move the debate forward, at least on the biotechnology issue. In early 2000, the United States and the EU were among 120 countries that signed the

¹⁵ The European Union has very recently adopted a regulation establishing a European Food Authority (FTA).

Biosafety Protocol, which established procedures for documenting the presence of GMOs in shipments of bulk foods or animal feeds. It also requires exporters to seek consent in advance from importing countries before shipping certain living organisms containing GMOs (including seeds for planting, for example). The Protocol also included language consistent with the precautionary principle, a tenet that has recently emerged from international environmental law. This holds that the lack of scientific certainty regarding the harmfulness of something should not be used to prevent a government from taking measures to protect the environment if there is a risk of serious or irreversible damage. In other words, restrictions can be placed on an action or product if it is believed to cause serious environmental harm, even if the scientific evidence is incomplete. The Protocol did not, however, apply the precautionary principle to food safety issues, which are largely governed by the Safety and Phyto-Sanitary Standards (SPS) and Codex Alimentarius rules. The Protocol also specified that it was not intended to replace science-based decision making or to alter the obligations of the members under the WTO.

Although the Biosafety Protocol seems to demonstrate that these issues can be addressed in a constructive manner, it is too early to judge the implementation and enforcement of its provisions. Moreover, negotiation of the Protocol has highlighted transatlantic differences over the idea of precaution. In the United States, the tendency is to regard as safe a process or product that has not been shown to be dangerous; while some in Europe want to require that a product be proven safe, something which is probably impossible in practice. The United States has warned that the precautionary principle cannot be used as a shield for protectionism. The EU is considering the possibility of extending the precautionary principle to health and consumer protection issues, and views this as consistent with its WTO obligations.¹⁶ The stage is thus set for future transatlantic disagreements over the application of the precautionary principle to new areas, its relationship to the WTO and its SPS agreement, and the criteria for insufficient scientific information. But the Biosafety Protocol demonstrates that specific agreements can be reached in this area. The task before the United States and the EU is to use that experience and the bilateral discussions on the precautionary principle to reach a consensus on that principle's definition and possible use before the next dispute arises.

Given the wide transatlantic differences on these new economy issues, it may be that discussions on a less official basis – perhaps through track-two diplomacy – could have a beneficial effect. Washington and Brussels have recently established the Biotechnology Consultative Forum, consisting of prominent scientists and representatives of business, agriculture, and consumer groups. The Forum is intended to discuss the benefits and risks of a wide range of biotechnologies and report to U.S. and EU leaders. It is too soon to assess the Forum, but a more important task may be that of building of a more general public consensus on this issue and others that arise of out new technologies. Here non-governmental panels could play an important role, allowing different perspectives to be aired, helping move the public debate forward, and perhaps even developing recommendations for policy. Although there has been some progress in intergovernmental consideration of biotechnology and internet privacy (safe harbor), both issues, as well as other e-commerce and regulatory matters, are likely to become the subject of intensifying public and parliamentary/congressional scrutiny in the next few years, and thus may be particularly suitable for future examination by such panels.

¹⁶ See “Council Resolution on the Precautionary Principle,” Presidency Conclusions, Annex III, Nice European Council, November 7-10, 2000. Viewed at www.europa.eu.int, November 13, 2000.

Conclusions

- 1) New technologies and industries will become a major part of the transatlantic economy during the next few years, creating more demand for action by governments, both to restrict trade and to enforce market access.
- 2) Although there are fundamental differences of approach between the United States and the EU on these issues, there are also important mitigating factors, as public attitudes and regulatory frameworks evolve on both sides of the Atlantic.
- 3) The WTO has not proven effective in addressing these politically sensitive issues and indeed may not be the most appropriate forum for considering these matters. Thus, the creation of alternative mechanisms on either a bilateral or multilateral basis is necessary.

Recommendations

- 1) The United States should press for greater clarity on the definition and use of the precautionary principle. If possible, this should be done through negotiations, and perhaps in concert with existing efforts within the Codex Alimentarius and OECD. In the short term, bilateral U.S. - EU negotiations may prove the best way to dampen transatlantic disputes on this issue.
 - 2) In order to enhance public understanding of issues related to these new technologies, as well as to advance the transatlantic governmental policy dialogue, it is time to establish nongovernmental task forces to examine specific issues. Depending upon the particular topic, they should include representatives of relevant public policy groups, labor, and business, as well as legislators. Areas that may be especially ripe for this treatment, given growing public and congressional interest, are biotechnology, internet privacy, e-commerce, and other regulatory issues, including perhaps environmental ones.
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V. Transatlantic Constituencies

The increased importance of investment in the transatlantic economic relationship and the development of new industries has also brought a change in those affected by U.S.-EU commerce, widening the circle of those who should have access to the policy process. Clearly, a broader group of government regulatory agencies will have to be involved, and there will be more participation by local and state governments and their European equivalents. Legislatures have always been part of the transatlantic trade dialogue, but their involvement will undoubtedly increase as the transatlantic economic relationship increasingly impacts their constituents.

But beyond new governmental actors, representatives of civil society and private interests are already becoming more prominent players in the transatlantic relationship. The key question is how to incorporate these actors into the process in a constructive way. Since the failed Seattle WTO summit, there is a general recognition that governments must make greater efforts to engage with the concerns of civil society. Among the transatlantic governments, there appears to be genuine commitment to include civil society and other groups in policy discussions, despite the difficulties of adding more participants to the policy dialogue.

As part of that effort, under the 1995 New Transatlantic Agenda, the United States and the European Union brought into their policy process four non-governmental dialogues: the Transatlantic Business Dialogue (TABD), the Transatlantic Labor Dialogue (TALD), the Transatlantic Environmental Dialogue (TAED), and the Transatlantic Consumer Dialogue (TACD). These dialogues have varied enormously in terms of their effectiveness and their involvement in the policy process. All of the dialogues are able to submit papers concerning potential disputes to the U.S. government and the European Commission through the early warning system, and apparently do so with some frequency, but reviews of the effectiveness of this process have been mixed. The dialogues have all held meetings, most recently a joint meeting in Lisbon in June 2000, but except for the TABD, those meetings have rarely generated sustained follow-up action. Of course, the NTA dialogues are a relatively recent innovation and should be given sufficient time to develop before they can be fairly judged. Moreover, there is genuine value in the process of bringing these groups together, even if concrete products do not emerge. Such meetings allow diverse organizations and individuals to enhance their understanding of a wide range of perspectives and may lead to the construction of networks that eventually enhance the policy process.

The TABD, which actually preceded the New Transatlantic Agenda, has proven by far the most effective of these dialogues. It has come to play a notable part in the policy process, particularly in such areas as the negotiation of mutual recognition agreements, which establish industrial standards for a range of goods and services. Recently, however, the TABD has been viewed with increasing disappointment by some observers and participants who had hoped it would take on a leadership role in pushing governments toward greater transatlantic cooperation. In the eyes of these critics, the TABD has become too focused on technical issues, such as standards. While this criticism may be justified, it is also true that corporate participation in TABD in part depends on the value of the dialogue in addressing some key bottom-line issues. Despite any weaknesses, the TABD has been a valuable part of the

transatlantic debate and should be encouraged both to pursue detailed agreements and to encourage transatlantic cooperation.

Of course, business interests have long been integrally involved in the U.S.-EU economic policy dialogue. The TABD represents the formalization of a business-government consultative process that had already existed. The more innovative part of the NTA was the creation of parallel labor, environmental, and consumer dialogues, which reflect the increasing importance of including these groups in the policy discussion. If the transatlantic relationship is to weather the transition to a more integrated, high-technology economy – an economy in which the two domestic regulatory and political environments are closely intertwined – it will have to include representatives of the civil society affected by that economy.

However, the experience to date of the consumer, environmental, and labor dialogues is not very encouraging. While the TABD has now met regularly for several years, there was considerable delay after the signing of the NTA before first meetings of the other dialogues were held. In most cases, these dialogues have not yet focused on a concrete set of policy recommendations. Recently, the very existence of the environmental dialogue has been called into question because of a lack of funds. This does not mean that these dialogues are irrelevant. Even more than in the case of the TABD, the process simply of bringing these groups together is an important step forward. In most cases, the environmental and consumer groups had not been part of a transatlantic network, while contacts between U.S. and EU labor unions had primarily occurred within the context of organizing campaigns. Furthermore, given the brief period over which these dialogues have been meeting, it would be unrealistic to expect much progress on specific issues.

Nevertheless, the experience to date of the NTA demonstrates some difficulties that will hinder efforts to make these civil society dialogues an effective part of the policy process:

Within each dialogue, there is considerable diversity among the participating organizations. Diversity can be a desirable attribute. However, when NGOs are brought together to discuss common issues but discover that they differ significantly in their political agendas and operating style, it can be a complicating factor. The TAED, for example, included large established organizations such as the World Wildlife Fund and the National Wildlife Federation, as well as smaller, more politically activist groups. There are also considerable differences between European and U.S. environmental NGOs, both in political outlook and in long-term goals.

Many NGOs may lack the resources to be effective in a transatlantic dialogue. The relative success of the TABD in part reflects both the ease at which multinational corporations operate in the international arena and the resources they have at their disposal. Similarly, the major labor unions are well-funded, and their staffs are increasingly experienced in collaborating internationally. This is not the case with many of the environmental and consumer organizations, which often lack both financial resources and personnel with international experience. In the past, these groups have focused their efforts on national governments, since that is where relevant legislation has been written. But as rules are increasingly affected by international negotiations, these groups may find it necessary to look toward the international arena as well. This will involve additional resources and different skills

that may not always be available. Indeed, to date, NGO participation in the transatlantic dialogues has been funded in part by governments and a few foundations.

The priorities of the civil society groups may differ from those of the official U.S.-EU dialogue. Groups active within the transatlantic dialogues are active on a wide range of issues. In some cases, these issues are central to the official dialogue between Washington and Brussels, but in others, they are only peripheral and the concerns of the civil society groups are best addressed in a forum other than the bilateral transatlantic dialogue. For example, many of the key issues for consumer groups – such as GMOs and hormone-fed beef – are central to the official transatlantic policy debate. Internet privacy is another consumer-oriented issue that is receiving increased government attention. The same can be said for some environmental concerns, particularly trade-related issues such as the use of the precautionary principle, or reductions in environmentally harmful subsidies. But other environmental issues, such as developing country practices and the establishment of international environmental standards, are not high on the transatlantic agenda. The most environmentalists can aim for is securing support from Brussels and Washington to negotiate basic global standards within an appropriate multilateral forum. Similarly, the primary international goals of labor – establishing basic standards on such issues as child labor and the right to organize – have generally not been major U.S.-EU concerns. The most unions can attain is enhanced transatlantic cooperation in supporting such standards in multilateral negotiations.

These difficulties should not lead to the conclusion that the transatlantic dialogues should be discontinued. On the contrary, the NTA process should be allowed to mature. Even if concrete and practical policy recommendations do not come out of the meetings, it will be useful for these communities to build closer ties across the Atlantic. Labor, for example, may find the NTA process inappropriate for achieving some of its key aims. But this does not mean that there is nothing of interest in those discussions. As transatlantic investment has grown, representatives of U.S. labor have increasingly focused on the disparities in how labor is treated in the United States and the EU, and have started to examine whether certain European mechanisms, such as workers' councils, might be appropriate for this side of the Atlantic. NTA dialogues provide opportunities for such discussions. It is also important to maintain the link between these dialogues and the official policy discussions, as a means of enhancing communication between civil society and government. The NTA dialogues have been a start in that direction.

In addition to maintaining and where possible improving the NTA dialogues, it is time to establish other mechanisms for including civil society and other non-governmental groups in the policy debate. These mechanisms should take into account the wide range of perspectives that should be involved, and also focus on issues that are both relevant to civil society and central to the U.S.-EU policy debate. They should offer opportunities for linking civil society not only to the U.S. executive branch, the European Commission, and EU member governments, but also to legislative bodies on both sides of the Atlantic. Two proposals in particular emerge from this discussion and the earlier comments on new technologies and industries.

1) Creating Issue-Oriented Task Forces. These would involve representatives from all the relevant civil society groups, as well as business, and perhaps some government participation. Exactly which constituencies and which specific groups should be involved would

be determined by the topic under examination. The individuals and organizations involved in a task force on biotechnology would be very different from those participating in an e-commerce forum. Such a task force could have several goals: to enhance public and official understanding of a particular issue (including scientific and technical aspects); to develop specific recommendations that would be submitted to Washington and Brussels; or to explore possibilities that may be far outside the government discussion but that may contribute to a solution. The topics selected for consideration should be specific enough so that discussions could be constructive and focused (the Biotechnology Consultative Forum, for example, has a very wide area of examination). The topics should also be timely in that they can be expected to be the subject of government decision making and transatlantic negotiation in the next one to three years. Potential topics may include the use of GMOs and internet privacy, along with other regulatory areas.

In any such undertaking, the selection of the participating groups will be critical and should be undertaken with great care. It should be acknowledged that some civil society groups are motivated by a fundamental opposition to international trade and thus have little interest in seeing genuine progress made on the issues facing the United States and the EU. Many other groups are dedicated to finding effective solutions to the current dilemmas in the transatlantic relationship and would be constructive participants in the policy process. In the middle are groups that honestly seek a constructive solution, but have little experience in a non-confrontational negotiating environment in which compromise is inevitably required. If possible, representatives of the two latter types of groups should participate; their perspectives will be valuable and these task forces will undoubtedly be a learning experience for all involved.

2) *Strengthening the U.S.-EU Parliamentary Dialogue.* Along with the civil society dialogues, the New Transatlantic Agenda created an exchange between the U.S. Congress and the European Parliament (EP). Since legislators have been directly involved in the policy process on both sides of the Atlantic – and have been key to both the outbreak and resolution of certain disputes – there should be a stronger mechanism through which they can exchange perspectives and jointly examine issues of mutual concern. Moreover, legislators do represent (in the literal sense) civil society; accordingly, Congress and the EP have been active on almost all issues of concern to civil society groups. Thus, enhancing the parliamentary dialogue could not only create greater understanding between the legislative bodies themselves, but it may also be an effective way to bring the concerns of responsible civil society groups directly into the policy process. Efforts should especially be made to bring together not just those legislators who have traditionally been interested in transatlantic issues but to extend the dialogue to those who are more focused on trade, investment, telecommunications, science and technology issues, and perhaps even agriculture. Legislators could also be included in the issue-specific task forces proposed above.

Conclusions

- 1) Although the involvement of business and labor in the U.S.-EU economic policy dialogue is well established, other constituencies, including environmentalists and consumers, have been underrepresented. While governments will obviously remain the main parties in the policy process, without the increased participation of these groups in some manner, it will be even more difficult to resolve many of the most sensitive issues on the current transatlantic economic agenda.
- 2) The dialogues established under the New Transatlantic Agenda have had somewhat mixed success. Where possible, they should be strengthened and improved. Certainly, the relatively young NTA process should be allowed to mature before any real judgments are passed.¹⁷
- 3) Effective participation of both existing and new constituencies might be better attained through discussions focused on specific issues that are central to the current official dialogue and also priorities on the agendas of responsible civil society representatives.

Recommendations

- 1) While the NTA dialogues should be continued, new fora should also be established. Each should focus on one high-priority issue, such as GMOs or internet privacy, and bring together a wide range of civil society and government representatives determined to make a constructive contribution.
- 2) The U.S.-EU parliamentary dialogue should be enhanced. A broad spectrum of current policy issues should be examined, and legislators should participate based on their expertise and interest in specific topics. The start of a new U.S. administration and Congress is an excellent time to launch such an effort.

¹⁷ William Antholis comments, "The report (both here and in the detailed discussion) dodges the issue of whether the U.S. government should fully fund the TAED, whose funding has been held up by the Senate Foreign Relations Committee. In the absence of such funding, this dialogue is unlikely to continue, given the limited resources from foundations and other private charitable organizations for transatlantic cooperation."

VI. Beyond the Transatlantic Agenda

The U.S.-EU economic relationship is undergoing a major transition. Once primarily a trading partnership, transatlantic interaction is increasingly dominated by mutual investment. New technologies and their associated industries are also coming to the fore, creating both transatlantic partnerships and potential conflicts that were never imagined just a few years ago. Through investments and acquisitions, industries and corporations from both sides of the Atlantic are more closely linked than ever before. Yet they still face very different regulatory and tax regimes in the U.S. and the EU; a situation which can lead to differential treatment for products, businesses, and labor. These regimes, once considered purely a matter of domestic concern, are now the focus of transatlantic discussion and, sometimes, conflict.

The intrusion of the U.S.-EU economic relationship into the domestic arenas, coupled with the growing role played by new high-technology industries, has enhanced political sensitivities. This has naturally brought into the arena new groups of actors, both governmental and private. Transatlantic economic policy now involves a wider range of government departments and agencies than ever before. State and regional governments will be key in many decisions, while regulatory agencies, such as EPA, FDA, and OSHA will also be increasingly involved. Just as important, the views of various constituencies must be heard in the U.S.-EU economic policy process, including those of labor, environmental, and consumer groups, as well as business. Given the growing political sensitivity of many of the issues now central to the transatlantic relationship, failure to include these groups will only lead to stalemate. These changes will also require new structures and mechanisms for managing the U.S.-EU economic relationship. A few have been sketched here, but more will evolve over time.

The implications of this transition for the transatlantic relationship itself are enormous. But they are also significant for the larger role of the United States and the European Union in the world economic system. They will probably lessen the priority given to those international institutions that remain focused on trade, while giving more emphasis to those arrangements that address the greater and growing interdependence of their economies. In particular, over the past few years, the WTO has demonstrated its usefulness in many ways, but also the difficulties it faces in handling a few key issues. At the moment, the political sensitivities and rapid changes surrounding these matters do not make them amenable to resolution through a juridical process, which is the most prominent new feature of the WTO. Thus, it is likely that both Washington and Brussels will send fewer disputes to the WTO, instead seeking more flexible mechanisms for dispute resolution. Coupled with the U.S. reluctance (and developing country resistance) to having the WTO take on new areas of responsibility, such as investment and competition policy, any new Round is likely to be limited in the range of its agenda.

But despite this limited scope, the convening of a new Round in the near future is still essential, for several reasons:

- First, a Round may provide opportunities to resolve some of the more persistent transatlantic disputes and thus reinforce the proposed bilateral effort to settle these persistent disagreements. By providing an arena in which there are many possible trade-offs, a Round may make compromise on long-entrenched positions more palatable.

- Second, a Round is also required in order to reach a settlement on agriculture by the end of 2003. At that time, the so-called peace clause exempting the EU's Common Agricultural Policy from WTO challenge will expire; a deadline that is expected to precipitate numerous cases against Brussels. Although agriculture is a small part of U.S.-EU trade (and an even smaller part of the total bilateral economic interaction), it is politically important both in Europe and the United States. Bilateral agricultural negotiations are currently underway, but the consensus so far is that a final settlement will only come through a Round.
- Third, a new Round will undoubtedly precipitate discussions about other issues, such as investment and competition. A multilateral agreement is probably premature, and so a preliminary accord may best be negotiated in a U.S.-EU framework, perhaps then developing into a plurilateral process involving countries that agree to abide by the same standards. But discussions in conjunction with a Round will remind all concerned that the eventual goal should be to return to the multilateral arena. For these reasons, a new trade Round in the near future is necessary.

At the same time, future WTO Rounds may occupy a less prominent place in the evolution of the international economic system. Instead, the WTO machinery may be joined by other multilateral regimes focused on a variety of issues. Many of these will emerge out of transatlantic bilateral discussions and agreements, but only if the United States and the European Union commit themselves to overcome their internal political differences and make serious progress on these issues. They must then step forward, demonstrating leadership in extending these agreements into a multilateral framework.

The transition of the transatlantic economy will also affect relations with other players in the international economy. In particular, the United States and the EU will be forced to grapple with many issues of regulation, competition, and standards for which there is not yet an international consensus. As Washington and Brussels reach accommodations on these matters (or thrash them out through mediation or even the WTO), developing countries are likely to find themselves left out of the discussion, particularly if multilateral negotiations continue to be delayed. Resentment may increase, especially given the need for access to the large and prosperous transatlantic market. The United States and the EU will have to devise ways to create a constructive dialogue with the developing countries and others outside their bilateral discussions. Otherwise, the divisions that have currently blocked the multilateral negotiating process will only grow wider and more destructive.

Finally, the outcome of this transition will determine the ability of the United States and Europe to play a constructive leadership role in the world economy. They are the first to deal with a truly globalized economic system, one in which domestic and international concerns have melded together, and new modes of governance – or at least accommodation – have had to be developed. Their success or failure in bringing new actors into the policy process, and in coping with the issues raised by emerging technologies and industries, will provide many lessons, serving either as a blueprint to be followed or as a demonstration of the possible pitfalls. As the transatlantic economy evolves, Washington and Brussels will undoubtedly focus on their own bilateral needs and priorities. But they should also remember that bilateral success is only the beginning; the true measure of success will be if the transatlantic economic transition contributes to the building of international prosperity in an era of globalization.

ANNEX

Comments by Working Group Members

William Antholis

This report provides a clear statement of major impasses in the transatlantic trade relationship. However, the report understates the global context for the relationship. This problem is particularly acute in the proposed solutions to the various problems, where the group suggests that we bypass the global system in seeking solutions.

The body of the report does have references to the added complications of dealing with developing country concerns, for instance the failure of the MAI agreement and the failure of the WTO round. Developing countries are now critical to both trade processes that need adjustment, such as the dispute resolution system and the negotiation of a new round, and substantive dispute areas such as labor and environmental standards or intellectual property and investment. For instance, the report calls for informal U.S.-EU resolution of several disputes, even though developing countries may be wary of this process on matters that directly or potentially affect them, such as bananas, foreign sales corporations, or genetically modified organisms.

This is not to say that the transatlantic relationship is not central to addressing global trade issues. It certainly is. Nor is this to say that the report should spend a lot of time on developing countries. It should not. But the U.S. and Europe will simply be patching holes in a back log of trade issues if they do not begin to address these problem from their shared perspective as global leaders. In particular this will mean being aggressive in striking partnership with developing countries.

I.M. Destler

Through intergovernmental consultations and the transatlantic dialogues, the United States and the EU should explore compromise proposals concerning the controversial issue of inclusion of labor and environmental standards in future trade negotiations. These issues are not going to go away, but any steps to address them must take into account practical difficulties and the sensitivities of developing nations. Recent suggestions by U.S. business, environmental, and labor NGOs could serve as a starting point.

Gary Clyde Hufbauer

The thrust of the recommendations of the working group's report for U.S.-EU trade disputes can be stylized in the following way: first, settle outstanding disputes on a bilateral basis, then launch a new WTO round of multilateral negotiations. I think this sequence is at odds with the practical difficulty of settling four highly contentious disputes: beef, bananas, FSC, and Airbus/Boeing.

The approach I prefer is for the United States and the European Union to agree on a "peace clause" for these highly contentious disputes. Under the peace clause, both sides would step back from retaliatory measures, while preserving their legal rights under the WTO. The peace clause would expire December 31, 2003 – a date that coincides with the expiration of the WTO's existing peace clause on potential agriculture subsidy disputes.

The United States, EU, and other WTO members could then launch a new trade Round at the Qatar Summit in the fall. A major agenda item for the round – possibly an ‘early harvest’ – would be to reach an accommodation on both the outstanding disputes and agricultural trade.

Thomas M.T. Niles

Speaking personally and not on the behalf of the members of the U.S. Council for International Business, I generally concur with the Atlantic Council paper’s stress on the need for a new effort to improve U.S.-EU relations. However, I would like to make the following observations on specific points in the paper:

– While I believe a discussion of investment issues with the EU Commission and the member states would be useful, I do not agree that we should seek to negotiate an investment agreement with the EU. To begin with, the European Commission has not been given a mandate by the member states in this area. Secondly, while we have disagreements on some issues in the investment area, they are neither so serious nor so likely to be resolved as to justify such an effort. Finally, I support the negotiation of a high-standards agreement on investment such as what we attempted with the MAI in the OECD. Unless we were able to achieve the objectives we set for the MAI and have achieved in our Bilateral Investment Treaties (BITs), I fear that a lower-standards agreement would undercut our ultimate objective of a high-standards agreement.

– Regarding competition policy, efforts are underway, in response to a proposal by former Assistant Attorney General Joel Klein, to broaden and deepen the international consultative process among competition policy official. Anything done in the U.S.-EU context should keep that initiative in mind.

– Regarding the so-called “precautionary principle,” I strongly disagree that measure with effects in the trade area can be taken in the absence of good scientific evidence that a product or process may be dangerous.

– New fora to enrich the transatlantic dialogue are not needed. Existing ones should be used.

Solveig Spielman

The basic recommendation of this working group report is that both the United States and Europe need to renew our determination to build and strengthen a cooperative and mutually beneficial economic relationship. To do this, we need to soften the edges of our approach and our debate, and we need to look in the mirror. Both sides should look closely at the attitudes and experiences they carry into the relationship, and both need to work harder to understand the attitudes on the other side. We need to see ourselves as others see us, tone down the rhetoric, and very consciously seek points of agreement in preference to points of conflict. When agreement cannot be found, we should value and respect the role of outside mediating bodies like the WTO that can help bring issues to closure. At home, we need to fight the temptation to present issues as zero-sum, “winner-loser” contests, and instead seek to re-legitimize compromise as a politically acceptable course.

As the transatlantic relationship broadens to include more stakeholder, more interests, and more groups, the issues will also grow more complex and more, rather than less, political. Our challenge will be to keep the political stakes from rising so much that problems seem bigger rather than smaller, and that instead of getting simpler, processes for taking action get even more complex and convoluted.

We cannot allow the transatlantic relationship to become another stage for domestic politics. This report is a call for statesmanship on all sides. Business organizations from both the United States and Europe have already done a great deal to establish avenues for dialogue and promote understanding and good will. The work of the Transatlantic Business Dialogue, the European American Chamber of Commerce, and others will have a pivotal role to play in the days ahead. It is important that business leaders continue to give these activities their attention and support, and that governments do what they can to encourage these private sector initiatives.

Paula Stern

The Transatlantic Business Dialogue represents a much more significant advance in trade policy than is portrayed in the report. In fact, the TABD represents a paradigm shift in the process of trade negotiations, moving the initiative from government negotiators to the business interests that deal directly with the complexities of transatlantic commerce everyday. For the first time, the U.S. and European business communities are jointly developing specific recommendations which they then pass on to their respective governments. Although TABD has been criticized as being focused too narrowly on specific technical issues, that is in fact the dialogue's comparative advantage. TABD has succeeded precisely because it has addressed key matters such as standards that have a real impact on the bottom line. And it has continued to receive high-level attention within the business community because such negotiations are complex, often with package deals across different sectors that require final agreement by CEOs rather than simply at the level of technical expert.

But despite its success, the TABD is now at a critical point. While the transatlantic business community has done its part by developing significant mutual recognition proposals, the U.S. and European governments have been slow to implement the intergovernmental accords that followed. Frustrated by the extent of bureaucratic resistance and inertia in this area, some critics say the TABD is beginning to drift. Whether it will recapture a clear sense of direction will depend on the skill of the TABD leadership in identifying new priorities and on the ability of government and business to work together to address those issues effectively.

The U.S. Congress, like their counterparts in the European Parliament, are elected to represent all constituencies – business, workers, consumers, etc. – in society, and their participation is key to bridging differences across the Atlantic. With new leadership in the White House and other capitals and new trade, agriculture, environmental, and foreign policy disputes compounding a fraying U.S.-EU relationship, the TABD *initiative* is greatly needed.

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