The **Open Atlantic Prosperity Area** proposed in this study would remove the current obstacles to transatlantic trade and investment to give a boost to wealth creation for the whole of humanity.

This Atlantic Prosperity Area is not designed as a free trade area but intended as a WTO-plus agreement to serve as a building block for wider world free trade. Barriers to trade and investment between the European Union and the United States of America, such as government procurement discrimination, antidumping policies, safeguard provisions, public subsidies, differing standards, protectionist consumer and environmental regulation and discriminatory judicial decisions would be brought down, leading to full Atlantic economic integration.

The Atlantic Prosperity Area must be an open club. A novel application of the Most Favoured Nation clause translates into open access to any third country wanting to join, if ready and willing to fulfil the conditions accepted by the Atlantic partners, thus resulting in a super-Doha offer to the rest of the world. Members of NAFTA, members of the European Economic Space and many other Latin American nations, which share democracy and common values with the EU and the US, would be natural partners of the Atlantic Prosperity Area.

Special care would be taken to give this Atlantic Prosperity Area a multilateral dimension by fusing US and UE programs for LDCs into a single *Multilateral Development Agenda* and implementing more effective development policies, especially through increased international trade. The Atlantic Prosperity Area would thus provide a new impulse to the fight against poverty.

The Atlantic Prosperity Area would deliver substantial and permanent welfare gains to both EU and US citizens as well as to the rest of the world, even before any other nation joined. Higher growth and more and better jobs would be generated, especially in Europe, where economic stimulus and new dynamism is much needed.

This study has been supported by Fundación FAES, a Spanish think tank working in favour of free markets and individual freedom. Fundación FAES is chaired by José María Aznar, President of the Government of Spain in 1996-2004.

ISBN
84-89633-35-5

faes
Fundación para el análisis y los estudios sociales

PVP: 12 €

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A CASE FOR AN OPEN ATLANTIC PROSPERITY AREA

Francisco Cabrillo, Pedro Schwartz and Jaime García-Legaz. *The case for an open Atlantic Prosperity Area.* Madrid: FAES, Fundación para el Análisis y los Estudios Sociales, 2006

FAES, Fundación para el Análisis y los Estudios Sociales
does not necessarily identify with the opinions expressed in the texts it publishes.

ISBN: 84-89633-35-5
Depósito Legal: M-xxxxxxxxx
Impreso en España / Printed in Spain

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Published by
FAES
Fundación para el Análisis
y los Estudios Sociales

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FOREWORD

José María Aznar

The United States of America and the European Union share common values on democracy, respect for human rights and individual liberty, promotion of peace and collective security and economic freedom are at the core of our civilization. Many friend countries share these values.

The Atlantic link is crucial to both Europe and America. The United States, as well as Latin American nations, cannot be understood without Europe, and a free and democratic Europe after the defeats of dictatorships in 1945 and 1989 is a reality because of the United States. For the last fifty years, the Atlantic relationship has been central to the security and prosperity of our people.

The European Union and the United States share common principles and objectives, and face the same threats.

1) Europeans and Americans face the threat of Islamic terrorism. After the terrorist attacks in the US, Spain, Great Britain and Turkey, we are persuaded that global security threats are more effectively dealt with together than alone.

2) Europeans and Americans share the same concerns about global human challenges like poverty and pandemics.

3) The EU and US are concerned about global warming and both need to improve energy efficiency, increase the diversity of energy sources and ensure a safe and secure form of energy supply.

While the Atlantic drift weakens both the EU and the US, and as President Bush as claimed, “when Europe and the US are united, no problem and no enemy can stand against us”.

We Europeans and Americans must work closely together in many fields, so the Atlantic link needs to be reinforced. Cooperation is much needed is the economic field.

The New Transatlantic Agenda and the Transatlantic Economic Partnership have laid the foundations for a strong economic link accross the Atlantic, but too many obstacles to trade and investment still remain. Our aspirations for the future must surpass our achievements in the past.

The proposal to create an open Atlantic Prosperity Area such described in this book is the proper way to reinforce the Atlantic link in the economic field. European and US citizens would benefit from increased trade and investment, reinforced competition, more innovation and higher productivity, leading to substantial and permanent welfare gains in terms of higher growth and more jobs. The European Union would be the one to benefit most from these gains. The rest of the world would also benefit from this initiative.

On the eleventh anniversary of the New Transatlantic Agenda, there is a unique opportunity to adapt the Transatlantic Economic Partnership to the new reality and to deeply reinforce the Atlantic economic link. We need political commitment at the highest levels. The Atlantic agenda should be given the necessary political priority.

Moreover, relevant stakeholders such as the TransAtlantic Business Dialogue and the Transatlantic Policy Network must continue to help making the Atlantic link the driving force of European, American and global prosperity. Their support to this project, which is in line with their proposals, is also crucial.

PREFACE

This essay is, we hope, an advance beyond previous works dealing with the transatlantic economy.

First of all, it is an advance on the data used in earlier studies, such as those from the Johns Hopkins University. We emphasize the analysis and theoretical foundations for defining the transatlantic economy, and for forecasting the gains from further transatlantic liberalization.

Secondly, we analyse the barriers to the transatlantic economy taking into account not just sectoral obstacles but also horizontal barriers, which are frequently underestimated or not even noted in other pieces of research. Government procurement, antidumping policies, safeguard provisions, public subsidies, standards, decisions by regulatory bodies and court decisions are just a few examples.

Thirdly, we not only focus on the bilateral Atlantic relationship, but also on the multilateral dimension of the Atlantic partnership. The United States of America and the European Union should not become a fortress of prosperity, but the driving force behind global prosperity.

Fourthly, we make a concrete proposal for action: the implementation of both an open Atlantic Prosperity Area and the Multilateral Development Agenda.

Finally, we stress that we are not ideologically neutral. We consider ourselves free market economists and consequently we have a deep-rooted belief in the free market and free trade.

We would like to thank prof. Robert Mundell, prof. Arnold Harberger, prof. Xavier Sala-i-Martí, prof. Daniel Gros, prof. Patrick Messerlin, prof. Juan Velarde, prof. José T. Raga, prof. Jaime Requeijo, prof. Rodríguez Braun, prof. Luis Gámir, prof. Joaquín Trigo, Alberto Recarte, Alberto Nadal, Álvaro Nadal, Antonio Fernández-Martos and Valentín Bote for their extremely valuable contributions. We are also deeply grateful to Gerardo del Caz and Juan Pablo Riesgo for their assistance in producing this research. The views expressed are those of the authors and not those of Fundación FAES, to which the authors are extremely grateful for its support.

Francisco Cabrillo
Pedro Schwartz
Jaime García-Legaz

EXCUTIVE SUMMARY:

THE CASE FOR AN OPEN ATLANTIC PROSPERITY AREA

- *The right political moment is now*. The political moment is ideal for the European Union and the United States to forge an historic Atlantic economic agreement in 2006. The EU has a year-old Parliament and a new Commission that now needs to propose a new economic program impetus to give Europe a new goal after the political setback of the proposed European Constitution. The US re-elected George W. Bush as president a year ago and he holds a fast-track negotiating authority till mid 2007. Statements of goodwill have come from both sides of the Atlantic, as previous clashes between the US Government and some European governments have been replaced by hopes of strengthening ties in the years ahead. Meanwhile the G8, with the co-leadership of the EU and US, reached an historic agreement in Greenagles on debt cancellation in favor of the poorest countries in the world, though a feeling that this is not enough to set them on the path to sustained growth may help further concessions in other areas, especially trade. Finally, after the deceiving results of the Hong Kong meeting, the WTO Doha Development Round is in danger of failing and a proposal imbued with the spirit of the Most Favoured Nation clause, such this Atlantic Prosperity Area, could help set it in train again.

- *The Atlantic Prosperity Area (APA).* We propose the launching of a new, comprehensive US-EU trade and investment liberalization agreement rooted in cooperation: the Atlantic Prosperity Area. The APA would pursue full transatlantic trade and investment liberalization, leading to full economic integration between the EU and the US by removing all type of trade and investment barriers. Regulatory barriers are at the core of the current disintegration of the transatlantic market.

• *The Atlantic Prosperity Area would deliver higher growth and more and better jobs for both EU and US citizens.* The transatlantic economy is the freest in the world, but it is not fully free. Substantial gains would result from a new initiative designed to deepen and re-energize the transatlantic economy through increased trade, higher investment and stronger flows of knowledge between the EU and US.

— More efficient resource allocation, reinforced competition, more intense and better-quality research and development activities, and increased innovation would boost economic growth, increase per capita income and create more and better jobs both in the EU and the US. The OECD estimates that further transatlantic liberalization could lead to substantial and permanent gains in welfare in the United States and Europe.

— The internal and external dimensions of the EU Lisbon Agenda and the Services Directive would receive a shot in the arm. Progress on the Lisbon Agenda is an important element for reinvigorating the transatlantic economic relationship, since: (1) many barriers fragmenting the European market would fall under the onslaught of transatlantic competition; and (2) a more competitive EU would provide a stimulus to the transatlantic economy.

• *The creation of an open Atlantic Prosperity Area would boost the World economy spontaneously; and a joint EU-US Multilateral Development Agenda would help spread the prosperity to less developed nations.* A growth engine such as the APA could by itself enhance the prosperity of other nations rich and poor.

— A more productive transatlantic economy would greatly contribute to prosperity in the broader global community, if care is taken to make it trade creating rather than trade diverting.

— Transatlantic prosperity must mean more than a spontaneous push to commerce by dint of a larger and freer market uniting both shores of the North Atlantic. There must also be a commitment to foster and spread prosperity globally.

— The expansion of global trade through the WTO Doha Development Round and a joint Atlantic agenda supporting development worldwide are strategic goals to be pursued.

— We endorse an EU-US joint Multilateral Development Agenda as a necessary complement of the Atlantic Prosperity Area.

• *The Atlantic Prosperity Area must be an open club*. By means of a novel application of the Most Favoured Nation clause, the APA would be open to any third country wanting to join, if ready and willing to fulfil the conditions accepted by the Atlantic partners. This would be equivalent to the Atlantic partners *effectively offering the world a super-Doha*, an offer which would reinforce a successful WTO Round or keep the flame of free trade burning if the process were to stall.

• *This comprehensive, ambitious and renovated Atlantic initiative would be based on two pillars, bilateral, and multilateral.* The EU/US dialogue suffers from a lack of political engagement at the highest levels of responsibility. What is needed is a major advance across the board, not partial and limited progress. The APA would aim for:

— Totally free transatlantic flows of goods, services, capital and knowledge. Also desirable would be free movement of people between the US and the EU, at least for employment purposes.

— The offer of a super-Doha that would multilaterally broaden this bilateral effort in four ways:

(a) opening the free trade agreements of the US and the EU with third countries to the partner on the other shore of the Atlantic; these countries would be offered a full opting-in possibility in the APA.

(b) offering Most Favoured Nation (MFN) treatment in trade, finance and the "Singapore issues" (investment, competition policy, transparency in government procurement and trade facilitation) to all countries ready to comply with its working rules and firmly committing to fulfil them.

(c) consolidating all the preferential Economic Partnership Agreements of the US and the EU with their favored LDCs into a single mutually open arrangement; and

(d) agreeing on a single negotiating platform for the Doha Round that would include not only further toppling of barriers to international exchanges but most importantly a unilateral renunciation of anti-dumping policies, safeguard provisions, public subsidies and domestic price guarantees.

• *A Road Map is needed.*- An agreement should be formalized between the partners with the following key points:

— The identification of barriers in the transatlantic economy.

— An action plan to remove these barriers, once national security goals are met. This should include:

(a) a road map outlining the steps to be taken; with a specific timetable for their removal;

(b) area-specific actions and stages and respective target dates for completion;

(c) area-specific dialogues between regulators and legislators;

(d) benchmarking procedures and feedback mechanisms;

(e) an *ad hoc* commission with full powers to supervise progress and solve conflicts but no permanent secretariat;

(f) a detailed definition of the conditions applied within the APA that must be extensible on a equal footing to countries wishing to invoke this novel form of MFN clause.

• *Political leadership is required.* Such an ambitious agenda will require consistent and committed political action over many years. Up to now, the EU-US Positive Economic Agenda and the Regulatory Road Map have not produced sufficient results. No real progress will be possible without high-level political leadership to help clear decision-making logjams bilaterally and multilaterally. An Atlantic leadership of this kind is needed to energize the Doha round: the "Doha-plus" offer of the APA could inspire countries around the World and lead them to a much needed further step towards free trade.

CHAPTER 1.
WHY WE NEED A NEW ATLANTIC INITIATIVE

THE NEED FOR A NEW ATLANTIC ECONOMIC INITIATIVE

Leaders from the European Union and United States agreed at the EU-US summits in June 2004 and June 2005 to look at new ways to make the Atlantic economic relationship stronger, and to give it new impetus[1]. The US President, the President of the European Commission and EU heads of state and government called for innovative proposals to further develop the transatlantic market in the twenty-first century[2]. They called on all interested parties "on both sides of the Atlantic to engage in a vigorous discussion of concrete ideas on how to further transatlantic economic integration to the fullest, spur innovation and job creation, and better realise the competitive potential of our economies and enterprises"[3]. These proposals were reviewed at the 2005 US-EU Summit and have formed the basis for concrete future initiatives[4].

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[1] This step was taken inspired in part by the Transatlantic Policy Network's groundwork on the Transatlantic Market. See Transatlantic Policy Network (2003), "*Economic Recommendations"* and "*Economic action point. 1"* in *"A Strategy to Strengthen Transatlantic Partnership"*, Washington/Brussels 2003, pp. 22-23, available at http:// www.tpnonline. org/pdf/1203Outreach.pdf

[2] *EU-U.S. Declaration on Strengthening Our Economic Partnership (2004)*, available at http://europa.eu.int/comm/press_room/presspacks/us20040625/summit_declarations.pdf

[3] See http://europa.eu.int/comm/external_relations/us/consultation/index.htm

[4] See *"The European Union and the United States Initiative to Enhance Transatlantic Economic Integration and Growth"* (2005).

Available at http://europa.eu.int/comm/external_relations/us/sum06_05/declarations/eco.pdf

We strongly believe that 2006 is crucial for the Atlantic relationship. The political moment is right for both the EU and the US to overcome past divisions, overcome pessimism[5], help to avoid future risks of a transatlantic drift and lay the basis for a historical Atlantic economic agreement.

The EU has a one-year-old Parliament and a new Commission. The US re-elected George W. Bush as President a year ago. In addition, he holds a fast-track negotiating authority till mid 2007. Statements of goodwill have come from both sides of the Atlantic accompanied by hopes of strengthening ties between the EU and the US in the years ahead. Legislators on both sides of the Atlantic have also underlined their willingness for renewed cooperation[6]. Moreover, an Atlantic initiative goes hand-in-hand with European Commission President Barroso's priority of implementing economic reform and improving EU competitiveness and of creating "an important opportunity for near-term action", as well as with the wishes of both President Bush and Tony Blair, the European Council President for the second half-year of 2005, to reinforce the Atlantic link[7].

Moreover, under the EU and the US leadership, the G-8 has reached an historic agreement on debt alleviation in favour of the poorest countries in the world. Once again, Atlantic leadership is proving to be the driving force of world progress.

The new teams in place have three years in front of them to build a new relationship and re-invigorate the transatlantic partnership.

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[5] Cfr. Tod Lindberg, H. Daalder, Francis Fukuyama and Walter Russell Mead, "*Troubled partnership. What's next for the United States and Europe"*, The Brookings Institution, November 10, 2004.

[6] See European Parliament (2005), *"Resolution on transatlantic relations"*, P6_TA-PROV(2005)0007, January 13, 2005, available at *www.europarl.eu.int*; cfr. U.S. House of Representatives Resolution 77, introduced by Jo Ann Davis of Virginia on February 9, 2005, referred to the House Committee on International Relations. Some Government think tanks such as Spanish Real Instituto Elcano have stated that a Transatlantic Economic Area would be positive for the national interest. Cfr. Paul Isbell *et al.* (2005), "*Índice Elcano de oportunidades y riesgos estratégicos para la economía española*", n. 4, October, available at www.realinstitutoelcano.org

[7] See Center for Strategic and International Studies (2005), "*Test of Will, Tests of Efficacy*", 2005 Report of the Initiative for a Renewed Transatlantic Partnership, Washington, D.C., p. 32

This view is shared by most stakeholders. The UNICE statement is a good example: "European business wants to see the EU and the US work together as closely and constructively as possible to increase wealth, prosperity, well-being and security domestically, bilaterally and globally"[8].

We propose a renewed Atlantic economic initiative with two pillars. The first one, the Atlantic Prosperity Area, should pursue full bilateral trade and investment liberalization between the EU and the US, founding a club open to the rest of the world. The second pillar, the Multilateral Development Agenda, should reinforce cooperation within the multilateral institutions working in favour of development.

AN OPEN ATLANTIC PROSPERITY AREA

What the Atlantic Prosperity Area is about

In 2004, the European Commission and the US Administration organized a series of consultations aimed at bringing forward new ideas on how to further transatlantic economic integration, enhance investment and trade flows, and identify and overcome obstacles to the realization of the competitive potential of our economies. They both wanted to progress beyond the reports published in the existing annual review of trade barriers by the European Commission and US Government, and to consider more far-reaching ideas.

A large number of responses to these consultations have been received[9], leading to a positive assessment by the European Commission[10]. After a first

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[8] In December 2004 UNICE supported the "launch of a comprehensive transatlantic trade and investment liberalization and cooperation agreement at the next Transatlantic Summit planned to take place end of June 2005 in Washington". See UNICE (2004), "*The Future of the Transatlantic Economic Relationship. Time for a New Initiative: A Comprehensive Transatlantic Trade and Investment Liberalization and Cooperation Agreement"*, statement released on 14 December 2004. Available on UNICE website: www.unice.org

[9] http://europa.eu.int/comm/external_relations/us/consultation/index.htm

[10] European Commission (2005), '*Strengthening the EU-US Partnership for the 21st century– Towards a barrier-free transatlantic market*', Communication from the Commission to the Council, the European Parliament and the Economic and Social Committe.

notional and strategic paper issued in December 2004[11], the present work tries to provide a comprehensive response to the issues raised.

We advocate "full transatlantic economic integration", a "100% barrier-free transatlantic market"[12] of 700 million people, generally wealthy and well educated by global standards, in other words an Atlantic Prosperity Area (APA). The concept is similar to the Transatlantic Market proposed by the TPN,[13] centred on the liberalization of key markets in the transatlantic economy.

The APA pursues totally free transatlantic flows of goods, services, capital and knowledge. Totally free job-related movement of people between the European Union and the United States is desirable as well, but we recognize that the security of individuals and the State is a superior goal which must also be achieved. Moreover, there can be no prosperity without security.

The project of creating an Atlantic Prosperity Area should be formalized through an agreement. A new formal partnership agreement between the United States and the European Union, and not just its member states, is needed to secure the Atlantic relationship and manage its development cooperatively, and to encourage greater involvement of lawmakers on both sides of the Atlantic.

The implementation of the Atlantic Prosperity Area requires:

1. The *identification of barriers* in the transatlantic economy.

This task must be done in a detailed way, on a sector-by-sector basis. Chapter 4 goes into this question.

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[11] Cabrillo, F., Schwartz, P. and García-Legaz, J. (2004), '*The Transatlantic Economic Area',* Papeles FAES. Available on FAES website: www.fundacionfaes.org

[12] See Erika Mann (2003), *'The Transatlantic Market – A leitmotif for economic cooperation'*, Draft Paper, November, p. 21. Available on http://www.erikamann.com/scripts/

[13] This concept is similar but not identical to the completion of the Internal Market in 1992 in the European Union. Building on progress made in existing agreements and initiatives, most importantly the New Transatlantic Agenda, it combines transatlantic regulatory convergence as well as improved transatlantic political cooperation and dialogue in a two-track strategy to achieve a more open transatlantic market area. See Elles, J. (2005) "*The Transatlantic Market: A reality by 2015?*", Paper presented at the CSIS TPN meeting, April.

2. An *action plan* with detailed and specific proposals to remove the barriers which have been identified.

The action plan should make specific proposals for removing barriers on a sector-by-sector basis, as well as overall. Chapter 5 refers to this issue. The action plan should also include:

— A concrete timescale for the removal of barriers and the completion of the Atlantic Prosperity Area.

— Area-specific actions and stages and respective target dates for completion, against which medium-term progress could be measured. Area-specific dialogues between regulators and new consultation mechanisms between both sides also need to be implemented.

— Benchmarking procedures, which are essential for effective progress and implementation of the agenda.

— A road map outlining the course of action for the implementation of the APA.

— An institutional structure for political supervision. The annual EU-US summit meetings should be established as the core institutional structure overseeing the process of fully implementing the APA.

— Feedback mechanisms on proposed regulatory changes to be introduced by regulatory agencies, businesses and other interested parties[14].

All these elements would create further momentum for action by EU and US political leaders.

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[14] The TPN, in its *Strategy to Strengthen Transatlantic Partnership* currently envisages a general target date of 2015 for the completion of a transatlantic market, and an accelerated target date of 2010 for five areas: financial services and capital markets, civil aviation, the digital economy (privacy, security and intellectual property rights), competition policy, and regulatory cooperation. See Transatlantic Policy Network (2003), "*A Strategy to Strengthen Transatlantic Partnership*", Washington/Brussels, p. 23, Available on http://www.tpnonline.org/pdf/12030utreach.pdf

Neither a free trade area nor a customs union

The APA does not propose the creation of a free trade area nor a customs union. In theory, nothing could stop the EU and the US from following the path offered by the GATT and GATS and setting up a transatlantic free trade area for both goods and services. However, the APA does not aim at the creation of a two-dimensional free trade area in goods and services.

A traditional initiative to create a FTA for goods and services would be capable of eliminating some of the existing barriers between the European and American economies (tariffs, quotas and other non-traditional barriers), but it would not be capable of dealing with the most damaging barriers for the transatlantic economy (regulatory barriers resulting from consumer protection, government procurement or different standards). Moreover, a FTA would probably lead to trade diversion. In addition, a preferential trade agreement between the EU and the US would prove detrimental to their shared long-term interests in global tariff reductions and trade liberalization.

So “the aim is not a transatlantic free trade area”.

An open club

By means of a novel application of the Most Favoured Nation clause, and in order to avoid inefficiencies resulting from trade diversion and political criticism if the APA were to become a “closed club just for the rich”, the APA should be a club open to any third country wanting to join, if ready and willing to fulfil the conditions accepted by the EU and the US, which would be public, transparent and non-discriminatory. Third countries joining the APA would benefit from both the EU and US open markets.

This would be equivalent to the EU and US offering a super-Doha to the rest of the world.

Internal and external dimensions of the EU Lisbon Agenda

The internal and external dimensions of the Lisbon Agenda can potentially reinforce each other. Progress on the Lisbon Agenda is an important

prerequisite for the reinvigoration of the transatlantic economic relationship. A more competitive EU would provide stimulus to the transatlantic economy[15]. In addition, many barriers fragmenting the European market would fall under the onslaught of transatlantic competition.

Moreover, deepening the Atlantic link could help Europe to catch up with the US in terms of productivity. The productivity gap between the European Union and the United States can be reduced by removing the transatlantic barriers. As the OECD has recently stated, research strongly suggests that more open product markets translate ultimately into higher productivity growth. Such a boost would be especially welcome in Europe. A transatlantic bridge for productivity is much more attractive and productive than theories of "counterweights" or the issue of "Europe vs. America".

Recent political decisions blocking transatlantic and intra-European mergers and acquisitions are just the opposite of what we need (examples are French government interference in the takeover bid for the French company Danone by the US multinational Pepsico, and the interference of the Bank of Italy in the attempted takeover of the Italian Banca Nazionale del Lavoro by the Spanish multinational bank BBVA).

At the same time, trade practices of third countries affect the performance of EU companies. We will not elaborate on this wide-ranging and complex issue in this report.

Renewal of growth in Europe will also facilitate the implementation of the multilateral agenda. In a more rapidly growing European economy it will be easier to accommodate the more rapid pace of resource re-allocation (job destruction and new job creation) that the opening up of markets to third countries will inevitably generate.

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[15] We believe the 'Kok Report' shows the right way forward for the EU to improve its economic performance. Cfr. V. Kok, "*Facing the Challenge",* November 2004.

Available on http://europa.eu.int/growthandjobs/pdf/kok_report_en.pdf

THE BENEFITS OF THE ATLANTIC PROSPERITY AREA

Substantial welfare gains would result from a new initiative designed to deepen and re-energize the transatlantic economy. Welfare gains would result from increased transatlantic trade, higher investment and greater flows of knowledge.

More efficient resource allocation, reinforced competition, more intense and better-quality research and development activities and more and better innovation would boost economic growth, increase income per capita and create more and better jobs both in the EU and the US. Higher employment and income would increase the guarantees of sustainability of welfare systems both in the EU and the US.

The estimates of potential welfare gains from EU-US liberalization in the literature differ depending on the scope of the studies, but all of them predict substantial welfare gains. The most recent study is by the OECD[16]. It estimates that further transatlantic liberalization could lead to permanent per capita income gains in the US and Europe of up to 3.5 %, i.e. the equivalent of a full year's income during a working lifetime.

These benefits would also accrue to the broader global community. Faster growth in the two biggest economies in the world would result in strong positive spillover effects for the rest of the global community. According to the OECD, trade linkages would spread the benefits of reforms in the United States and the European Union to other OECD countries, with an estimated increase in GDP per capita of up to 1.5%.

The precise assessment of these gains by the OECD is very helpful as a way of making people aware of the results of a new Atlantic initiative. As

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[16] See OECD (2005), '*The Benefits Of Liberalizing Product Markets And Reducing Barriers To International Trade And Investment: The Case Of The United States And The European Union*'; a previous study was published by the CEPR in 2002: "*Enhancing Economic Cooperation between the EU and the Americas: An Economic Assessment*", London. According to this study, lower estimates of welfare gains from transatlantic liberalization for the EU lay between 0.7% and 0.9% of GDP, while the most optimistic estimates ranged between 2% and 3%. For the US, the lower estimates from liberalizing with the EU were around 0.2% of GDP, with the most optimistic estimates ranging between 0.5% and 1.5%.

the Centre for Strategic and International Studies (CSIS) has pointed out, the results of the OECD assessment should serve to build broadly-based political support among policymakers and the general public on both sides of the Atlantic for a transatlantic partnership in a similar way that the Cecchini report provided the basis for the launch of the EU Single Market process in 1988[17].

Transatlantic barriers prevent us from reaping these gains. The costs of not fully implementing transatlantic economic integration are indeed huge.

THE MULTILATERAL DEVELOPMENT AGENDA

Transatlantic prosperity must also mean an Atlantic commitment to spread prosperity globally. The expansion of global trade through the WTO Doha Round and a joint Atlantic agenda supporting development worldwide must be pursued as strategic goals. Leaving to one side any opinion on its approach and scope, the recent G-8 agreement on debt cancellation for the poorest countries shows the potential of EU-US global co-leadership and cooperation.

Thus, we endorse an EU-US joint Multilateral Development Agenda as a necessary complement of the Atlantic Prosperity Area. This multilateral pillar is also favoured by Atlantic stakeholders.

POLITICAL LEADERSHIP IS REQUIRED

We think partial and small improvements to the details of the current Atlantic initiative are not satisfactory. We need substantial, major progress. A new Atlantic economic initiative should clearly indicate a new step in the relationship in its substance as well as in its symbolic content. For this reason, we propose the launch of a comprehensive transatlantic trade and investment liberalization agreement based on cooperation.

A comprehensive agreement would give a clear political and institutional visibility to the project, which will need high-level political commitment and

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[17] See Center for Strategic and International Studies (2005), "*Test of Will, Tests of Efficacy*", 2005 Report of the Initiative for a Renewed Transatlantic Partnership, Washington, D.C., p. 37.

parliamentary support on both sides. Such an endorsement would facilitate legislative work and contribute to overcoming current difficulties. The agreement would be based on cooperation, so as to indicate the political willingness on both sides to deal with each other constructively.

Such an ambitious agenda will require consistent and committed political action over many years.

Up to now, efforts to build a proper Atlantic framework have proved difficult. Multi-year efforts to negotiate sector-specific Mutual Recognition Agreements (MRAs) have resulted in large amounts of time and energy spent on relatively little return. In some areas where MRAs were negotiated, implementation has been poor. The EU-US Positive Economic Agenda and the Regulatory Road Map have not prospered sufficiently, because they have been taken over by trade negotiators, rather than advanced as part of an overall relationship framed by trade-offs and problem-solving mindsets. The decision adopted at the 2005 summit establishing a high-level Regulatory Cooperation Forum is a step in the right direction, but again it is not sufficient.

As James Elles MEP, President of the European Ideas Network, has pointed out, "Perhaps the most important deficit affecting these initiatives has been the lack of an overarching vision for a comprehensive redesign of the transatlantic economic partnership to mirror the consequences of deep economic integration. Yet such a vision is critical to attracting sustained political will among policymakers on both sides of the Atlantic that is needed to drive efforts at strengthening the US-European economic partnership forward"[18].

No real progress will be possible without high-level political leadership and "buy-in" to help clear decision-making bottlenecks, encourage EU and US regulators to adopt new, common approaches to rules and rule-making, and forge common positions between the United States and the European Union in key international fora such as the WTO. Atlantic leadership is needed to reshape and boost the global economy by energizing Doha globally and implementing a Doha-plus Atlantic agenda.

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[18] Elles, J. (2005) "*The Transatlantic Market: A reality by 2015?*", Paper presented at the CSIS TPN meeting, April.

CHAPTER 2.
COULD REGIONALISM AND MULTILATERALISM BECOME COMPLEMENTARY APPROACHES?

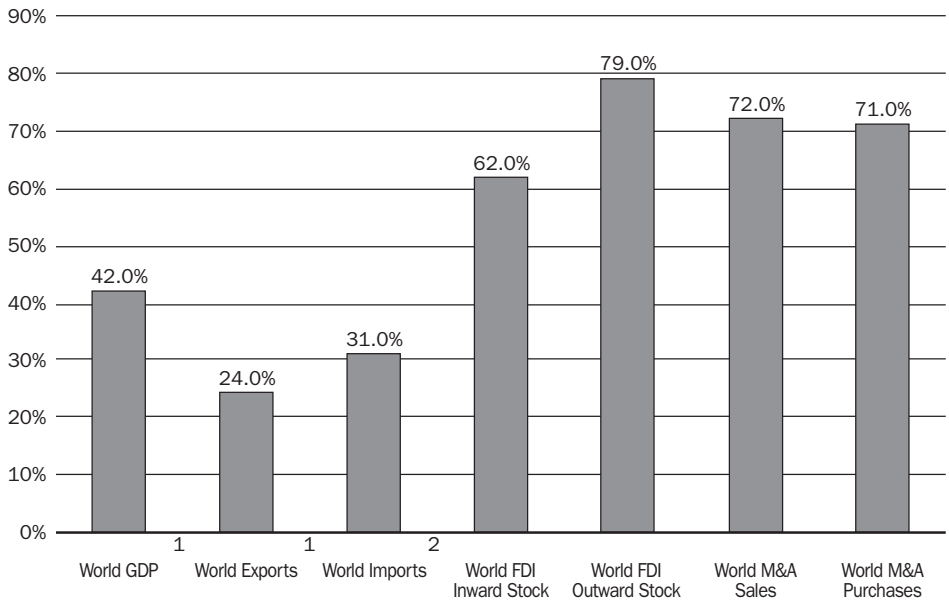
THE US AND EUROPE, THE ARCHITECTS OF THE CURRENT MULTILATERAL ORDER

The EU and the US: the two great actors in the international arena

Though big emerging markets like China and India attract much interest in the international economic arena, the EU and the US continue to play a dominant role in today's global economy. Others may be potential economic powers, but the current real economic powers are the EU and the US.

Graph 7.1 reveals the combined economic weight of the US and EU in the global economy, in terms of GDP, exports, imports, foreign direct investment and business presence.

Graph 7.1. The transatlantic economy vs. the world economy

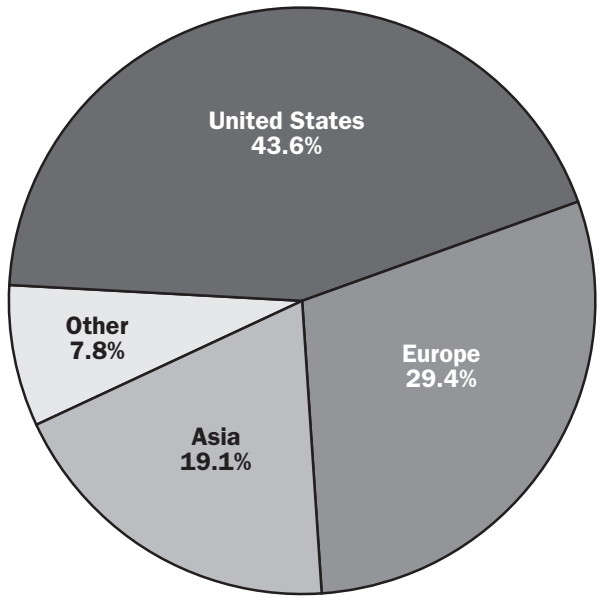


1 Based on PPP estimates.
2 Excluding intra-EU trade.
Sources: UN, IMF, official government sources. Figures for 2003. Hamilton and Quinlan (2005).

In 2003, the United States and Europe accounted for 42% of world GDP, 24% of global exports and 31% of global imports, absorbed 62% of global foreign direct investment (FDI) stock and were the source of 79% of the total global FDI outward stock.

The global supremacy of the US and EU economies extends to their presence in financial markets. This is shown in Graph 7.2.

Graph 7.2. The US and EU share of the global equity market



Note: Data as of May 31, 2005
Source: FactSet. Hamilton and Quinlan (2005)

Though difficult to measure, more than 75% of new knowledge available for humanity has been produced in the EU and the US.

The EU, the US and the multilateral institutions and initiatives

Transatlantic leadership was essential in creating and maintaining the multilateral framework of the post-war global economic system and its institutional lynchpins, the World Bank, the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT) - later the World Trade Organization (WTO).

Transatlantic cooperation has not only paved the way for a steady increase in transatlantic commercial ties since World War II, but has also provided the impetus for substantial achievements on the global stage. The most recent example has been the G8's 2005 agreement on debt alleviation.

The success of the transatlantic economic partnership has been such that, in the words of former US Under Secretary of Commerce, David L. Aaron, "the United States and Europe represent the twin pillars of post-war prosperity" in the global economy[1].

The EU and US joint promotion of global trade liberalization within the WTO rounds

The EU and the US have a long history of close cooperation in GATT and later in the WTO. This cooperation has underpinned their high level of economic interdependence, despite the absence of any formal trade or investment agreement between them.

While the Common Market dismantled protection in Europe, the GATT steadily knocked chunks off the protectionist walls between the more developed countries, and notably between the EU and the US. The US economy has behaved as the main engine for the growth of the world economy, especially in the 1990s. The GATT also accommodated the rise of Japan as an economic power, and the WTO might do so with China and India in the next few decades.

The GATT went through a period of upheaval when protectionist forces temporarily strengthened their hold, but it soon recovered its balance and has facilitated the integration of the Asian emerging economies into the global trading system, which in turn is helping to reduce poverty on a huge scale.

Together, the European Common Market, the US economy and GATT helped deliver a major part of the prosperity the world has enjoyed in the past half century.

The establishment of the World Trade Organisation was a notable culmination of decades of progress towards more open trade. Almost fifty years after the 1948 Havana Summit, the WTO represented the acceptance by the

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[1] See. David L. Aaron (2000), "The United States and Europe: seeking common ground", in George A. Bermann, Matthias Herdegen, and Peter L. Lindseth (Eds.), Transatlantic Regulatory Cooperation – Legal Problems and Political Prospects, Oxford: Oxford University Press, p. 25

industrialized world of a multilateral system of rules-based order, including a unique international arbitration system for settling trade disputes. This was a remarkable step, given that a similar proposal did not succeed in the immediate post-war area, when the other Bretton Woods institutions were established.

The close cooperation between the EU and US in the WTO was again demonstrated with the adoption of a new Doha Round framework in July 2004.

REGIONALISM AND MULTILATERALISM: THE ACADEMIC DEBATE

The controversy on regional trade arrangements is a classic one in international economics. The benefits and costs of regional trade agreements have been the subject of debate since the seminal work of Viner (1950). At the heart of the issue is the degree to which preferential regional trade agreements take the country towards free trade[2].

Reducing tariffs on imports will always directly benefit consumers by reducing prices. However, as the tariff reduction is only implemented on imports from the country's partners in the regional trade agreements, relative prices of imports from other (partner and non-partner) countries become distorted. As a result, a country may switch its source of imports to a partner, despite the non-partner being the cheaper source. This is trade diversion, and if the price disparity between exporters is sufficiently large, it can result in a country losing from membership of a regional trade agreement. In any event, the non-partner country is worse off through the loss of its export market.

These undesirable side effects of regional trade agreements can be offset by more broadly based trade liberalization. This would be most effective in the form of a multilateral trade agreement, such as the successful completion of a WTO round. In the absence of that, major trading partners can seek to reduce barriers to trade between them as a complement to their regional trade agreements[3].

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[2] Cfr. Jagdish Bhagwati's foreword in James Mathis (2003), "*Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement*", T-M-C Asser Press, The Hague, The Netherlands.

[3] Cfr. Richard Pomfret (1997), *"The Economics of Regional Trading Arrangements"*, Oxford University Press.

Questions such as why countries seek regional trade agreements[4] or whether continental trading blocks are "natural" are classical topics of academic discussion[5].

On a more pragmatic field, bilateral and regional trade agreements have always had their critics. The main argument against them is that these types of agreements weaken multilateralism and hinder global trade liberalization through the WTO rounds.

Many other experts disagree, and support bilateral and regional agreements as complementary ways to make free global trade move forward. Regional agreements are powerful tools to remove trade barriers and to dismantle protection mechanisms, facilitating future commitments and agreements in the WTO multilateral negotiations.

The "golden rule" should be to avoid trade diversion and not to interfere with the WTO system.

In our opinion, the answer is clearly no. Regionalism should not be demonized, especially if it is implemented by trying to avoid trade diversion. The WTO is a key institution in the international economic system, but we should remember that it is only an instrument for reaching a final goal, which is that of greater prosperity for people around the world. If there are other instruments to hand which allow us to advance in the same direction, we should not refuse to use them.

REGIONALISM AND MULTILATERALISM IN THE LIGHT OF THE IMPASSE IN THE DOHA ROUND

The unsuccessful results of Seattle, Cancun and Hong Kong have placed the Doha Round in a situation of *impasse*. Trade authorities must answer the

[4] Cfr. John Walley (1998), "Why Do Countries Seek Regional Trade Arrangements", in Jeffrey A. Frankel (Ed.), "The Regionalization of the World Economy", NBER, the University of Chicago Press.

[5] Cfr. Jeffrey Frankel, Ernesto Stein and Shang-Jin Wei (1998), "*Continental trading blocks: Are They Natural or Supernatural?*", in Jeffrey A. Frankel (Ed.), "*The Regionalization of the World Economy*", NBER, the University of Chicago Press.

following question: should the paralysis of the WTO multilateral approach necessarily translate into substantial costs for citizens and companies when trade liberalization could also be achieved bilaterally?

The increasingly obvious difficulty in reaching agreements in the WTO has given an impetus to negotiations on bilateral and regional trade agreements. They are easier to negotiate and also produce benefits for people. If they are designed as building blocks, what is wrong with that?

In the press conference held on his return from the Cancun Ministerial Meeting, the then European Commissioner Pascal Lamy wondered whether multilateralism should continue to be the main element of EU trade policy. In the United States, the then US Trade Representative Robert Zoellick also stated after the Cancun failure that if there was no multilateral advance, the US would re-launch negotiations of bilateral trade agreements. The poor results of Hong Kong do not change the picture.

It is the impasse in the multilateral approach, against the wishes of both the EU and US, which is leading to bilateral and regional agreements as complementary ways forward.

EU AND US TRADE POLICY: BILATERALISM, REGIONALISM, AND MULTILATERALISM

Beyond its political purpose, the founding of the European Union and its successive enlargements have been a response to a regional trade rationale. The EEC was born precisely as a regional trade agreement, applying the "regional" exception to the most-favoured-nation clause allowed under Article XXIV of the GATT. Its successive enlargements have been possible precisely because of the regional way forward.

The European Economic Area is based on the same idea. What is more, regionalism forms a natural part of the very history of the EU since its foundation. The EU (then the EEC or EC) has practiced a strongly regional trade policy for its nearly five decades of existence. We could point to the preferential agreements negotiated in the past with neighbours (Spain in 1970, or Poland and many others) and the preferential agreements now in place within the framework of its policy with neighbour countries. This regionalism of the EU in its trade policy is also reflected in the Lomé agreements with the ACP countries.

Moreover, the EU has never been slow in turning to preferential regional agreements with countries when the effects on trade flows of trade liberalization agreements between third countries have resulted in significant losses of market share for European exporters, as in the case of Mexico (a FTA already in force), Chile and the MERCOSUR countries (a FTA still being negotiated). They all fulfil the WTO-plus rule[6].

The EU has also signed many regional agreements: with countries in Central and Eastern Europe, before they began the process of accession; with Turkey, also before the accession process; with Morocco and other North African countries (Euro-Mediterranean agreements[7]), with Russia; and with Canada, among others. Apart from this are the preferential trade agreements with ACP countries through the Lomé and Cotonou agreements.

Nevertheless, on the European side, it is argued that an EU-US economic agreement would lessen the will to advance towards trade liberalization between the EU and Latin America. In response, it should be stressed that these interests are not opposed. There is no reason why there should be a trade-off between the APA and trade liberalization agreements between the EU and the MERCOSUR or Chile. Nor does the APA interfere with possible future proposals for trade agreements between the EU and the Andean Pact or Central America.

The US has also signed a large number of regional agreements, mainly in America, including, of course, NAFTA, a Free Trade Agreement with Chile, CAFTA-DR, but also many others, like the FTA agreement recently signed with Peru. Some of them are preferential, like the ones agreed with some ACP countries. Within America, a FTA with Colombia and Ecuador could also be signed in the future.

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[6] Cfr. Stephen Woolcock (2003), "*A framework for assessing regional trade arrangements: WTO-plus*", in Gary P. Sampson and Stephen Woolcock (Eds.), "*Regionalism, Multilateralism and Economic Integration. The Recent Experience*", United Nations University Press.

[7] Cfr. Tomas Baert (2003), *"The Euro-Mediterranean Agreements"*, in Gary P. Sampson and Stephen Woolcock (Eds.), "*Regionalism, Multilateralism and Economic Integration. The Recent Experience*", United Nations University Press.

The Free Trade Area of the Americas, aiming at a FTA covering the whole continent, has been in the political agenda for some years. After pro-communist anti-globalization boycott of the FTAA in Argentina in November 2005, and the absence of political will to go on with the FTAA in many South American countries, this initiative is likely to be stalled for some time.

So both the EU and US have a long record of trade agreements which prove their pragmatic approach to trade policy, including bilateral and regional preferential agreements, as well as multilateral agreements in the GATT-WTO system along history.

OPEN AND CLOSED REGIONALISM

The above considerations suggest the following conclusions:

1) There is no satisfactory alternative to multilateral rule-making as a way of promoting global trade effectively.

2) However, the bilateral approach can allow the EU and the US to cooperate more effectively in multilateral fora and facilitate consensus-building in these institutions, as well as to advance in areas where limited progress is expected in the multilateral framework, because either conflicting interests or the differences in levels of economic development make cooperation difficult.

3) Open regionalism, such the proposal for an open Atlantic Prosperity Area (an open club imbued with the spirit of the MFN clause), could provide overall benefits both for the Atlantic community and the rest of the world.

So there is no reason why the elimination of barriers between the EU and the US following a “building block” approach should prejudice the commitment of both economic powers to the WTO and the success of the Doha Round. In fact, as an essential complement of the open Atlantic Prosperity Area there should be a joint commitment by the EU and US to the WTO and the multilateral economic order as a whole. This point is dealt with in the chapter on the Multilateral Development Agenda.

CHAPTER 3.
THE TRANSATLANTIC ECONOMY

THE EU AND US: PARTNERS IN PROSPERITY

The EU and the US form the biggest economic area in the world, far ahead of any others. Between them they account for over 60% of global GDP and 40% of global trade. The transatlantic trade relationship is the most important one in the world with an average of more than €1 billion transatlantic trade and investment per day. These linkages underpin a $3 trillion economy that provides up to 14 million "insourced" jobs on both sides of the Atlantic. The EU and the US are each other's main commercial partners for goods and services.

Thus in spite of the media hype given to NAFTA, CAFTA-DR, the emergence of China and India, the "Pacific's Century" (referring to the twentieth century) and "big emerging economies" in the world economy, the fact is that trade, investment and financial flows across the Atlantic are much more important than flows between the transatlantic economy (the EU-US economy) and any other commercial areas or the bilateral flows between those third-parties[1].

What is more, and unlike what is generally believed, the transatlantic economy has experienced steady growth in size and depth since the end of

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[1] Cfr. Mann, Erika, (2003), *"The Transatlantic Market – A leitmotif for economic cooperation"*, Draft Paper, November, p. 21, available at *www.erikamann.com*; cfr. Transatlantic Policy Network (2003), *"A Strategy to Strengthen Transatlantic Partnership"*, Washington/ Brussels, p. 23 f., available at *www.tpnonline.org*

World War II and continues to show strong growth at present, despite political divergences and trade disputes[2].

The figures speak for themselves and give the lie to some common ideas which are without real foundation[3].

1) Transatlantic commerce totalled roughly $3 trillion in 2004[4].
2) Total transatlantic trade in goods reached an all-time record high of $482 billion in 2004, up 22% from 2003 ($395 billion).
3) Despite the "strong euro" exchange rate against the US dollar in 2004, US imports from the European Union jumped to a record $283 billion in 2004, helping to drive America's trade deficit with the European Union to an all-time high of $110 billion. In 2004, the US posted record imports from Germany ($77.2 billion), Italy ($28 billion), France ($31.8 billion), and other European nations. Surging imports from Europe led to record US trade deficits with a number of European nations in 2004, including Germany ($46 billion).
4) Combined US-European trade in goods and services during 2003 totalled $549 billion, with the EU receiving a third of all US exports and the United States being the destination of roughly a quarter of total EU exports.

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[2] See Quinlan, Joseph P. (2003), "*Drifting Apart or Growing Together? The Primacy of the Transatlantic Economy"*, Center for Transatlantic Relations, John Hopkins University-SAIS, pp. 7-9.

[3] See Hamilton, Daniel S. and Quinlan, Joseph P. (2004), "*Partners in Prosperity. The Changing Geography of the Transatlantic Economy*", Center for Transatlantic Relations, Johns Hopkins University–SAIS; See. American Chamber of Commerce to the European Union (2003), "*Europe & the US – Facts and Figures on Transatlantic Trade and Investment*", Brussels, September; cfr. UNICE (2004), "*The Future of the Transatlantic Economic Relationship. Time for a New Initiative: A Comprehensive Transatlantic Trade and Investment Liberalization and Cooperation Agreement*", statement released on 14 December 2004, available on UNICE website: www.unice.org; cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (eds), (2005), "*Deep Integration: HowTransatlantic Markets are Leading Globalization",* Washington, DC and Brussels: Center for Transatlantic Relations and Centre for European Policy Studies.

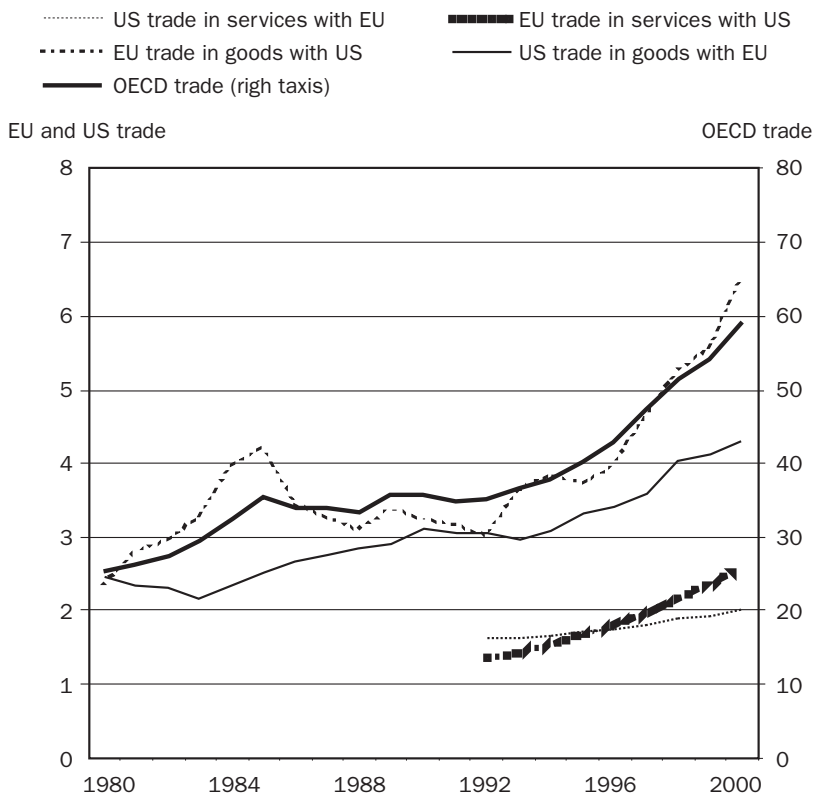
[4] That figure includes total two-way trade between the United States and Europe, plus total foreign affiliate sales, adjusted for potential double-counting of affiliate sales and exports/imports. See Hamilton and Quinlan (2005), op.cit. p. 3.

5) Contrary to general belief, two-way trade only accounts for 20%-25% of total transatlantic commerce (two-way trade plus foreign affiliate sales).

6) Trade squabbles often make the headlines, but currently represent less than 2% of the overall trade volume.

Graph 3.1 shows the growth of trade flows between the EU and US. The steady increase which this trade represents as a percentage of the GDP reveals the strengthening of the transatlantic trade relationship over the last two decades.

Graph 3.1. Trade flows as % of GDP in the EU and US



Trade is defined as the sum of exports and imports of goods between a reporting country and a partner country, as % of GDP of the reporting country. The diverging trends seen at times in the figure between European Union and United States trade is mainly due to exchange rate effects. Data for the OECD is a simple average of the ratio across OECD countries, and due to data constraints bi-lateral EU-US trade in services is only shown since 1992.
Source: OECD

Table 3.1. illustrates the general steady growth of trade in goods between the EU and US in 1999-2004.

Table 3.1. EU25 trade in goods with the USA
million euro

	1999	2000	2001	2002	2003	2004
USA						
Exports	186 573	237 588	244 881	247 044	226 526	234 140
Imports	165 340	205 643	202 533	181 824	157 386	157 670
Balance	21 233	31 945	42 348	65 220	69 140	76 470
Total extra-EU25						
Exports	689 434	857 782	895 843	903 549	883 047	968 215
Imports	746 622	995 980	983 748	942 207	940 814	1 029 464
Balance	-57 188	-138 198	-87 904	-38 658	-57 767	-61 249
USA/Total extra EU25						
Exports	27%	28%	27%	27%	26%	24%
Imports	22%	21%	21%	19%	17%	15%

Source: Eurostat

Table 3.2. breaks down this transatlantic trade in goods between 1999 and 2004 by product.

Table 3.2. EU25 trade in goods with the USA by product
million euro

	Exports		Imports		Balance	
	1999	2000	2001	2002	2003	2004
Total	**186 573**	**234 140**	**165 340**	**157 670**	**21 233**	**76 470**
Primary Products:	14 452	24 915	13 328	13 429	1 124	11 486
Food & drink	*7 958*	*9 800*	*5 569*	*5 272*	*2 389*	*4 528*
Crude materials	*1 800*	*3 023*	*6 168*	*5 655*	*-4 368*	*-2 632*
Energy	*4 694*	*12 092*	*1 592*	*2 502*	*3 103*	*9 591*
Manufactured goods:	168 440	205 303	146 983	141 334	21 457	63 969
Chemicals	*27 421*	*46 575*	*20 984*	*31 184*	*6 436*	*15 391*
Machinery & vehicles	*94 193*	*102 813*	*93 498*	*79 181*	*695*	*23 631*
Other manuf'd articles	*46 826*	*55 915*	*32 501*	*30 969*	*14 325*	*24 947*
Other	3 681	3 921	5 029	2 907	-1 348	1 015

Source: Eurostat

The most notable feature of EU-US trade in this period has been the continued growth in the EU-25 surplus, from just over 20 billion in 1999 to more than 75 billion in 2004. This increase in the surplus is in particular due to a decrease in the level of imports from the USA, which have fallen by a quarter from their peak of 205 billion in 2000. In relative terms, EU-25 imports from the US fell from 22% of total EU-25 imports in 1999 to 15% in 2004, while exports declined from 27% in 1999 to 24% in 2004. Around 45% of EU-25 exports to the US, and half of EU-25 imports from the US were "machinery and vehicles".

Table 3.3. offers information on the trade in goods of each EU member state with the US.

Table 3.3. EU25 and Member States trade in goods with the USA
million euro

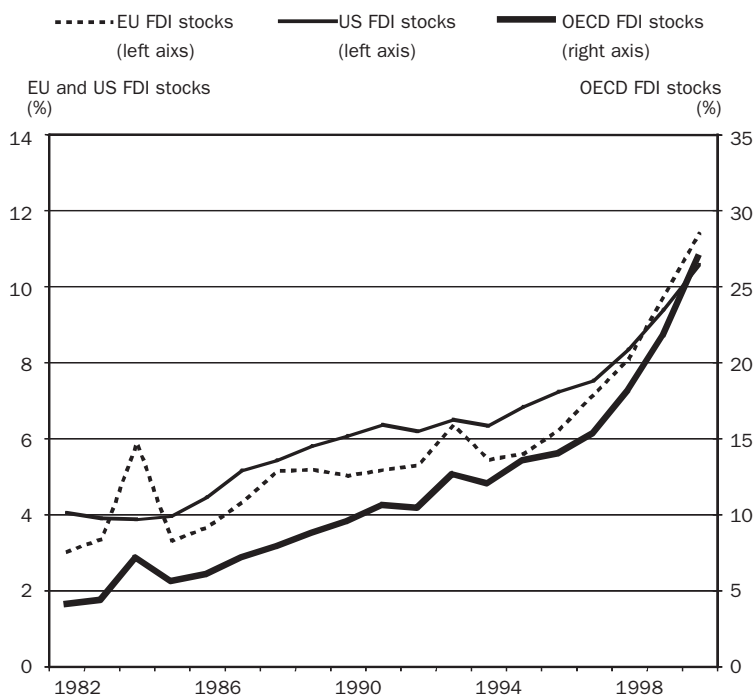
	Exports		Imports		Balance	
	1999	2004	1999	2004	1999	2004
EU25	**186 573**	**234 140**	**165 340**	**157 670**	**21 233**	**76 470**
Belgium	8 756	16 023	11 648	12 877	-2 893	3 146
Czech Republic	583	1 261	1 042	1 061	-459	201
Denmark	2 615	3 439	2 202	1 778	414	1 662
Germany	51 425	64 801	30 030	31 922	21 395	32 879
Estonia	43	152	91	113	-47	40
Greece	561	648	1 411	1 887	-850	-1 239
Spain	4 459	5 754	6 136	5 938	-1 677	-184
France	24 086	24 044	23 490	19 025	597	5 019
Ireland	10 242	16 500	6 957	6 750	3 286	9 749
Italy	20 547	22 374	10 024	9 993	10 524	12 382
Cyprus	12	13	156	108	-143	-94
Latvia	92	95	56	75	35	19
Lithuania	116	371	172	156	-56	214
Luxembourg	287	252	926	481	-639	-229
Hungary	1 220	1 336	909	1 34	311	302
Malta	396	333	225	160	171	173
Netherlands[3]	8 096	12 296	18 451	20 316	-10 355	-8 020
Austria	2 837	5 667	2 727	1 858	110	3 809
Poland	711	1 457	1 553	1 154	-842	303
Portugal	1 140	1 741	1 059	1 047	81	694
Slovenia	244	401	277	225	-33	176
Slovakia	140	1 060	272	253	-133	807
Finland	3 179	3 175	1 711	1 350	1 469	1 825
Sweden	7 307	10 532	4 086	2 949	3 221	7 583
United Kingdom	37 477	40 416	39 730	35 162	-2 253	5 254

Source: Eurostat

Among the EU25 member States, Germany was the largest exporter to the USA in 2004, with 65 billion, or 28% of the total, followed by the United Kingdom (40 billion or 17%). The United Kingdom (35 billion or 22%) and Germany (32 billion or 20%) were also the largest importers. Most member States recorded a surplus in trade with the US in 2004. The largest surpluses were registered by Germany (+33 billion), Italy (+12 billion) and Ireland (+10 billion), and the largest deficit by the Netherlands (-8 billion).

7) Investment is the most powerful driving force of the transatlantic economy. The core of the transatlantic economy is foreign direct investment (FDI), as well as the interrelated activity of foreign affiliates, not traditional trade.

Graph 3.2. Trends in FDI in the EU, US and OECD (as % of GDP)[1]



FDI stocks are the average of the inward and otward positions of FDI stocks between a reporting and partner country. Data for the European Union exclude intra-EU FDI stocks. FDI for the OECD is calculated as a simple average of the ratio across OECD countries, and includes intra-EU FDI stock positions. The value for OECD stocks for the year 2000 is an OECD estimate.
Source: OECD

Taking into account that conceptual errors should be avoided when incorrectly comparing figures for stocks (accumulated foreign direct investment stocks) and flows (GDP), graph 3.2 shows clearly the deepening direct investment flows between the American and European economies, and is further evidence of the growing process of integration.

Table 3.4. offers data from Eurostat on FDI[5] flows between the EU-25 and the US. In 2003, the EU-25 invested nearly 54 billion euro in the US, and received just over 50 billion of US investment. The US was the largest investment partner of the EU-25, accounting for nearly 45% of both outward and inwards flows of FDI.

Table 3.4. EU25 FDI flows with the USA
million euro

		USA		total Extra-EU25	USA/ Extra-EU25
	2001	**2002**	**2003**	**2003**	**2003**
EU 25 FDI (outward)	139 184	-8 875	53 720	126 229	43%
FDI the EU25 (inward)	61 143	52 148	50 364	113 222	44%
Net EU25 FDI flows (outward minus inward)	78 040	-61 023	3 357	13 007	

Source: Eurostat

Table 3.5. breaks down information on FDI according to countries. The United Kingdom was the main net investor in the US in 2003, with a difference of 21 billion. The Netherlands was the main net recipient of US FDI, with a difference of 14 billion.

[5] Foreign direct investment (FDI) is the category of international investment that reflects the objective of obtaining a lasting interest by an investor in one economy in an enterprise resident in another economy. The lasting interest implies that a long-term relationship exists between the investor and the enterprise, and that the investor has a significant influence on the way the enterprise is managed. Such an interest is formally deemed to exist when a direct investor owns 10% or more of the ordinary shares or voting power on the board of directors (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise). FDI flows presented in the tables include re-invested earnings, unless specified.

Table 3.5. EU25 and Member States FDI flows with the USA, 2003**
million euro

	EU FDI flows in the US (outward)	US FDI flows in the EU (inward)	Net EU FDI flows (outward minus inward)
EU25	**53 720**	**50 64**	**3 357**
Belgium	293	2 017	-1 724
Czech Republic	12	180	-168
Denmark*	103	671	-569
Germany	4 830	4 951	-121
Estonia	c	15	:
Greece*	20	-48	68
Spain*	1 776	3 856	-2 080
France	6 256	3 489	2 767
Ireland	-616	-4 033	3 417
Italy	606	720	-114
Cyprus	3	6	-4
Latvia	3	23	-20
Lithuania	:	16	:
Luxembourg	2 700	5 413	-2 713
Hungary	-4	240	-244
Malta	:	:	:
Netherlands	12 753	26 867	-14 114
Austria	88	792	-704
Poland	-16	486	-502
Portugal	51	84	-33
Slovenia	-61	9	-69
Slovakia*	1	6	-5
Finland	-1 249	669	-1 918
Sweden*	1 772	-1 251	3 023
United Kingdom	26 262	4 971	21 291

Negative sign stands for disinvestment
: Data not available
c Confidential
* Excluding reinvested earnings
** Data include Special Financial Institutions, holding companies specialised in marking FD Itransactions

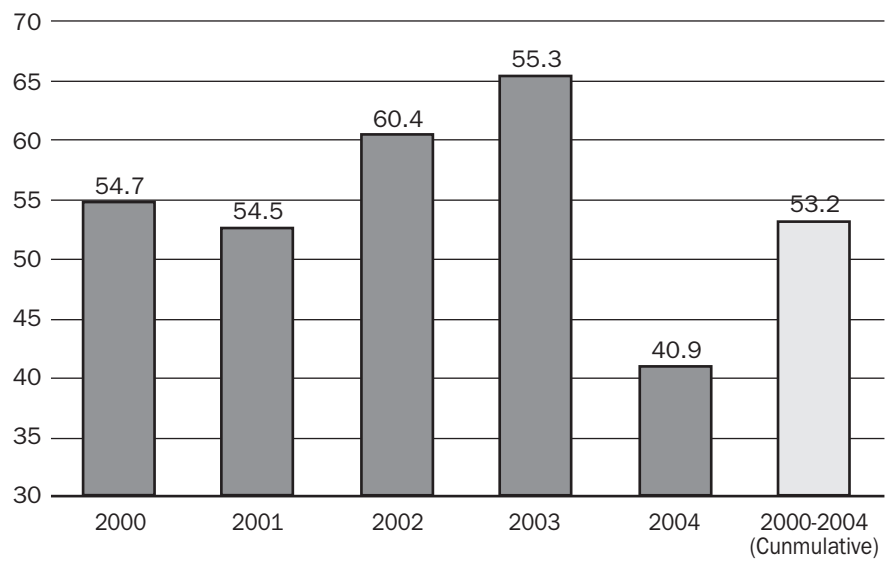
8) Sales through foreign affiliates (US affiliates in the EU and European affiliates in the US) are the essence of the transatlantic economy. Affiliate sales, not trade, represent the primary means by which European firms deliver goods and services to US consumers. Affiliates establish lasting linkages between the economies and broader societies of the United States and Europe and foster increasing

transatlantic interconnectedness through their assets, sales, profits and workforces on their respective sides of the Atlantic.

9) Europe accounted for half of the $3 trillion in global US foreign affiliate sales in 2002, well in excess of US exports of $975 billion. Europe accounted for half of total global sales, more than double the figures for the Asia-Pacific region. US affiliate sales of $48 billion in China in 2002, for example, were lower than sales to Spain ($57 billion) and well below those in Germany ($242 billion) or France ($140 billion). In 2002, European affiliate sales in the US ($1.2 trillion) were roughly three times larger than European exports to the US.

Graph 3.3. shows the steady flow of direct investment from America to Europe. More than 50% of direct US investment abroad is in Europe.

Graph 3.3. US foreign direct investment outflows to Europe (as % of total)



Source: Bureau of Economic Analysis, US Department of Commerce. Hamilton and Quinlan (2005).

10) US affiliates in Ireland accounted for 19.4% of Ireland's total GDP in 2002, a jump of 3.4% from 2001. US affiliates accounted for 6.7% of the UK's aggregate output and 5.5% of Belgium's total output in 2002.

11) The European Union accounts for 53% of US foreign affiliate sales of services, twice the figure for Asia, and four times that for Latin America. European service sales in the US have jumped 213% in ten years.

12) Europe accounts for 56% of the total global output of US affiliates.

13) European affiliates account for 64% of the total output of all foreign affiliates operating in the United States, and 60% of corporate America's foreign assets are located in Europe. US assets in Germany are greater than total US assets in all of South America.

14) Also contrary to what is sometimes believed, most US direct investment abroad is in the EU, and vice versa. In fact, the main destination of FDI of these two large economic areas are not emerging countries with low wage levels. To give just one example: in 2003, US direct investment in Italy was more than two and a half times that in China. US investment flows to Italy in 2004 ($4.2 billion) were four times as large as US flows to India ($1 billion).

15) European firms account for 75% of total foreign assets in the United States. European investment in many individual US states is greater, in any given year, than total US investment in Japan and China put together.

16) US companies invested nearly $100 billion in the European Union in 2003 and another $92 billion in 2004. US investment flows to the United Kingdom in 2004 ($23 billion) accounted for 25% of total US investments in the European Union as a whole. America's corporate assets in the United Kingdom exceed total US assets in the entire Asia-Pacific region. US foreign investment to the rest of Europe approached $70 billion in 2004.

17) Some 60% of the $5,800 billion of capital invested abroad by the US up to 2001 ($3,300 billion) was in the EU. US firms account for 70% of EU total foreign assets (3,700 billion dollars). Around 50% of US FDI in the 1990s was in Europe. During the first half of the 1990s, Europe

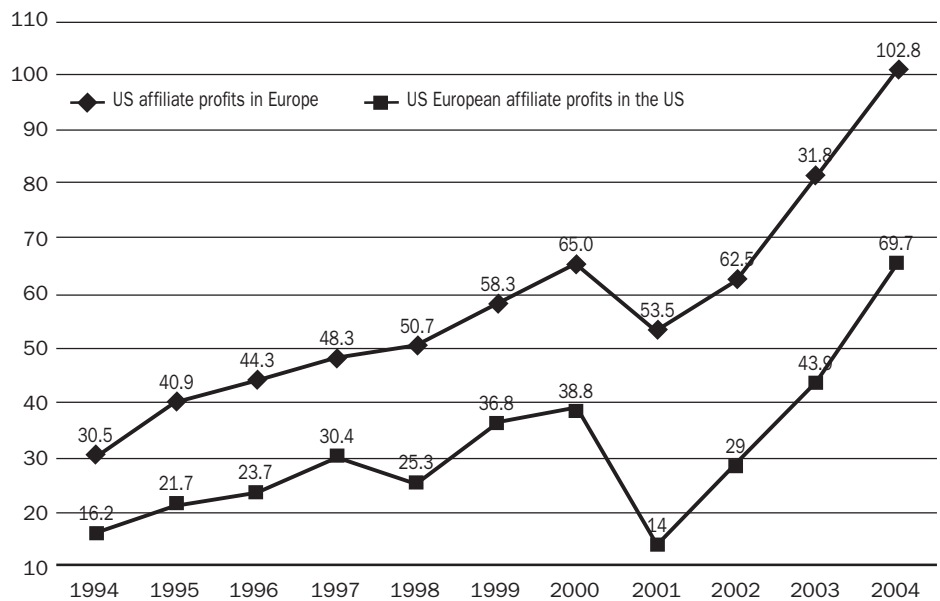
accounted for nearly 56% of total US FDI. European corporations have accounted for 75% of total FDI inflows into the US in the past five years, and now account for 75% of total foreign assets in the United States. Another example: the volume of US capital invested in the UK is over 50% more than the total US capital invested in Asia.

18) The EU is an essential source of capital supply for the United States. European firms account for more than two-thirds of total foreign assets in the US, and invested nearly $53 billion in the US in 2004, up from just $6.6 billion the year before.

19) European and US corporations derive the majority of their global profits from their US and EU subsidiaries.

Graph 3.4. shows the importance of mutual direct investment as a source of income in the form of profits. In both cases, growth is exponential, especially between 2000 and 2004.

Graph 3.4. US corporate profits in Europe through affiliates (1994-2004)
EU corporate profits in the US through affiliates (1994-2004)



Source: Bureau of Economic Analysis. Hamilton and Quinlan (2005).

20) European affiliate profits rose from $4.4 billion in 1990 to $46 billion in 2003. Despite the strength of the euro, European affiliate earnings in the US surged to a record $65.7 billion in 2004, a 38.5% jump from 2003, and affiliates from nine different European countries reported record US profits in 2004. Earnings of European affiliates in the US have increased more than four times since the US recession in 2001.

21) Earnings of US affiliates amounted to a record $100.8 billion in Europe in 2004, and US earnings from Europe have nearly doubled in the past five years. Europe accounts for half of total global earnings of US companies, as measured by US foreign affiliate income, and Europe remains the most important foreign source of global profits for US companies. US affiliate income in China is soaring, but US affiliates earn almost three times as much in Ireland and more than five times as much in countries like the Netherlands or the UK as they did in China. In 2004, US affiliates obtained record profits in 12 European countries. The United Kingdom ranks as the most important single national market in the world for corporate America when it comes to global earnings, accounting for 11% of total affiliate income in the first half of this decade. Not far behind was the Netherlands, with a 10.3% share of global foreign affiliate earnings[6].

22) A total of 132 deals in excess of $1 billion were concluded between 1998 and 2000.

23) Europeans invested over $100 billion in US securities in 2003-04. US net purchases of European equities in 2004 reached an annual record of $52 billion.

24) Most foreigners working for US companies abroad are employed in Europe and most foreigners working for European companies abroad are employed in the United States. En 2001, US companies directly employed 4.1 million workers in the EU, while European affiliates directly employed over two-thirds of the 5.4 million US workers on the payrolls of majority-owned foreign affiliates in 2002. A total of 14 million American and European jobs are directly or indirectly linked to transatlantic commercial activity.

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[6] See Hamilton, Daniel S. and Quinlan, Joseph P. (eds), (2005), "*Deep Integration: HowTransatlantic Markets are Leading Globalization",* Washington, DC and Brussels: Center for Transatlantic Relations and Centre for European Policy Studies.

25) Two-thirds of US corporate research and development conducted outside the US is conducted in Europe.

26) Transatlantic Internet bandwidth doubled between 2001 and 2003 and was 87 times that of European connections to Asia and the Pacific.

27) The US accounted for 37% and the EU for 31% of global financial stock in 2003.

28) The service economies of the EU and US are closely connected in sectors such as banking and investment, telecommunications, insurance, advertising and information technology.

Table 3.6. EU25 trade in services with the USA by product
million euro

	Credit		Debit		Net	
	2003	2004	2003	2004	2003	2004
Total	**110 114**	**118 374**	**101 053**	**103 336**	**9 061**	**15 038**
of which:						
Transportation	21 339	24 972	15 742	16 548	5 597	8 425
Travel	17 875	19 980	15 779	16 077	2 097	3 903
Other services	70 496	72 997	68 336	69 378	2 160	3 619
of which:						
Communication services	*2 177*	*2 462*	*2 511*	*2 736*	*-334*	*-274*
Construction services	*1 170*	*954*	*775*	*685*	*394*	*269*
Insurance services	*7 821*	*6 299*	*1 698*	*1 991*	*6 123*	*4 309*
Financial services	*7 916*	*9 140*	*4 358*	*5 351*	*3 558*	*3 789*
Computer and information services	*5 846*	*5 516*	*3 979*	*4 194*	*1 868*	*1 321*
Royalties and license fees	*6 896*	*8 521*	*16 236*	*17 006*	*-9 339*	*-8 485*
Other business services	*31 869*	*33 562*	*32 609*	*31 384*	*-740*	*2 178*
Personal, cultural and recreational services	*1 983*	*1 958*	*3 534*	*3 609*	*-1 551*	*-1 651*
Govemment services, other	*4 816*	*4 583*	*2 636*	*2 421*	*2 181*	*2 163*
Total extra-EU25	330 818	356 261	293 649	315 037	37 169	41 225
USA/total extra-EU25	33%	33%	34%	33%		

Source: Eurostat

Table 3.6. shows figures for trade in services broken down by sub-sectors. In 2004, the EU-25 exported a little less than 120 billion euro of services to the US, while imports of services from the US amounted to a little more than 100 billion. The EU-25 had a surplus of 15 billion in trade in services with the US, which accounted for a third of total extra-EU-25 trade in services. This surplus was mainly due to transportation services (+8 billion), as well as insurance, travel and financial services (+4 billion each), while royalties and license fees recorded the largest deficit (-8 billion).

Table 3.7. gives more information on trade in services broken down by EU member states. Among the EU-25 member states, and as for trade in goods,

Table 3.7. EU25 and Member States trade in services with the USA, 2003
million euro

	Credit	Debit	Net
EU25	**110 114**	**101 053**	**9 061**
Belgium	6 160	4 371	1 789
Czech Republic	337	331	5
Denmark	2 497	2 039	458
Germany	17 959	18 108	-149
Estonia	100	48	52
Greece	4 906	2 376	2 530
Spain	5 230	4 951	279
France	14 678	8 184	6 494
Ireland	4 545	15 077	-10 531
Italy	5 09	6 759	-1 750
Cyprus	347	292	56
Latvia	150	50	101
Lithuania	78	60	18
Luxembourg	1 079	950	129
Hungary	864	1 444	-580
Malta	:	:	:
Netherlands	6 689	7 118	-430
Austria	1 863	2 924	-1 060
Poland	:	:	:
Portugal	681	495	186
Slovenia	67	101	-34
Slovakia	212	206	6
Finland	391	1 031	-640
Sweden	3 871	3 967	-95
United Kingdom	31 661	19 447	12 214

Source: Eurostat

the United Kingdom (29% of total exports and 19% of imports in 2003) and Germany (16% and 18% respectively) were the largest traders of services with the US. Most EU member states recorded a surplus in trade in services with the US. The largest surpluses were registered by the United Kingdom (+12 billion) and France (+6 billion), and the largest deficit by Ireland (-11 billion).

29) The EU accounts for 32.1% and the US for 29.3% of the $2.6 trillion information and communication technologies sector, the most important engine of global growth and productivity. Nine of the world's top 10 telecoms firms are in the US or the EU.

30) Despite the transatlantic differences over the Iraq conflict, in 2003 US companies injected $87 billion in direct investment into the EU, 65% of US FDI for the year, and 30% more than in 2002. At the same time, 2003 was a record year for activity for US affiliates of European companies, and European companies invested $36.9 billion in the US, providing 74.7% of FDI in the US that year, 40% more than in 2002.

To sum up, the EU and the US are today more interconnected and interdependent than ever in the economic field. We can see that the economy has been moving far ahead of politics in this respect. The EU and US are thus partners in prosperity [7].

THE TRANSATLANTIC ECONOMY AND "NEW" INTERNATIONAL TRADE THEORY

The evidence related to the transatlantic economy should not be a surprise to international economists. On the contrary, it fits perfectly well into the "new" pure theory of international trade, that is to say, the new branch of international economics which has been able to provide solid economic

[7] See Hamilton, Daniel S. and Quinlan, Joseph P. (2004), '*Partners in Prosperity. The Changing Geography of the Transatlantic Economy*', Center for Transatlantic Relations, Johns Hopkins University–SAIS, p. 166.

foundations for trade patterns between economies with similar factor endowments.

Traditional pure theory of international trade (the Ricardian model of the comparative advantage or the Hecksher-Ohlin model) faces serious difficulties in providing a satisfactory theoretical explanation of the evidence defining the transatlantic economy. The US and the EU export and import basically the same type of goods (and services) and have basically the same relative resource endowments. In this respect, both the United States and Europe are capital-abundant economies, in the three forms of capital: physical, human and technological.

According to traditional trade theory, there should be little trade between the United States and Europe. However, evidence shows that strong and increasing trade flows exist. Evidence also shows that intra-industry trade is the main form of transatlantic trade, for which neither the Ricardian model nor the Heckscher-Ohlin model provides a theoretical basis.

New international trade theory takes into account increasing returns and product differentiation. When economies of scale and product differentiation (and monopolistic competition markets) become basic theoretical assumptions instead of constant returns to scale and traditional perfect competition market structures, the model predicts intra-industry trade flows[8].

That is just what the evidence shows: strong flows of intra-industry trade in automotive products, drugs, consultancy services and financial services, for example. These are just few examples of differentiated goods or services that both American and European firms produce and trade efficiently across the Atlantic.

As income per capita increases over time, consumer demand becomes more sophisticated and product differentiation intensifies. Thus, *ceteris paribus,* a steady growth of intra-industry trade is likely to be the main feature of transatlantic commerce in the future.

[8] Cfr. Helpman, E. and Krugman, P. (1985), "*Market Structure and Foreign Trade*", MIT Press, Cambridge, Massachussets.

THE LINKS BETWEEN THE EU AND US ECONOMIES: DEEP INTEGRATION, EURO-AMERICAN COMPANIES AND MUTUAL DELOCALIZATION

The fact is that EU and the US economies are not drifting apart; quite the contrary, they are integrating. With transatlantic trade doubling and investment flows quadrupling, increasing integration rather than divergence has been the defining feature of the transatlantic relationship over the past decade[9]. The evidence is conclusive.

Many analysts have been surprised by the striking evidence that the many differences currently afflicting the transatlantic economy coincide together with strong trends towards ever-deepening interactions between Europe and the United States. This is particularly true because EU-US integration is not the result of a formal agreement.

However, it is no surprise to us. In our opinion, Atlantic integration is simply a natural process resulting from the essential nature of Europe and the United States of America. Atlantic integration is the natural result of two economies and societies that share the same background, have similar resource endowments and basically share the same economic model. It would be surprising to expect otherwise. In other words, unnatural forces would be needed to make the US and the EU drift apart.

The EU and the US economies have become deeply intertwined in a number of specific areas. Two-way trade accounts for a small part of total transatlantic commerce, including trade and foreign affiliate sales, so that traditional approaches to economic integration do not get an appropriate picture of the depth of EU-US economic interaction. Moreover, many of the issues currently confronting European and American policymakers are those of *deep integration*[10], a new closeness that is qualitatively different than the

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[9] Elles, J. (2005) '*The Transatlantic Market: A reality by 2015?*'. Paper presented at the CSIS TPN meeting, April.

[10] Cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (eds) (2005), '*Deep Integration: HowTransatlantic Markets are Leading Globalization',* Washington, DC and Brussels: Center for Transatlantic Relations and Centre for European Policy Studies.

shallow-integration model of the Bretton Woods-GATT system established after World War II, based on traditional trade [11].

Exports and imports are the most common measurement of cross-border economic activity between nations, but trade alone is a misleading benchmark of international commerce in the context of deep integration. Foreign direct investment and the activities of foreign affiliates must also be considered. In other words, trade is a previous stage, a rather "shallow, underdeveloped form of integration". FDI and affiliate sales are indicators of deep forms of cross-border integration.

The transatlantic economy is tightly bound together by foreign investment. The massive bilateral transatlantic capital investment is proof of the depth of integration.

In this integrated transatlantic economy, corporations increasingly lose their formerly distinctive European or American identity as the combined transatlantic area becomes their "home base" region. We could call them *Euro-American* companies.

CAPITAL RE-ALLOCATION IN THE TRANSATLANTIC ECONOMY. MUTUAL DELOCALIZATION.

Industrial delocalization has become a hot issue in domestic political debates and attracts the interest of media in most EU member states and also the US. In the EU, concerns were first concentrated on delocalization to countries in Central and Eastern Europe. Some of them have already become EU member states. Delocalization to emerging Asian countries is the new source of concern. In the US, delocalization to China and other emerging Asian economies are being addressed by politicians.

Nevertheless, at the end of the day US-EU mutual FDI flows and the interrelated activity of foreign affiliates are not only at the core of the

[11] Cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (2004), '*Partners in Prosperity. The Changing Geography of the Transatlantic Economy*', Center for Transatlantic Relations, Johns Hopkins University–SAIS, p. 21.

transatlantic economy but also the main drivers of both EU and EU delocalization.

We may thus conclude that deep integration across the Atlantic is the result of mutual industrial delocalization.

This evidence deserves additional reflections on the political debate on delocalization.

First of all, capital movements from the US to the EU or vice versa do not seem to be led by "social dumping" or similar questions. Secondly, if neither delocalization from the EU to the US or from the EU to the US is "bad", why should other delocalization be so? Is there good and bad delocalization depending on the destination of investment?

Very often, neo-mercantilist political approaches to FDI are applied: incoming FDI is "good", outgoing FDI is "bad".

We believe this is a big mistake. Factor re-allocation is a sensible response of the economy to the relative scarceness of resources. Re-allocation (sometimes leading to delocalization) translates into more efficient resource allocation and is thus a source of efficiency gains.

This is the case when delocalization from the US leads to FDI in Europe, but also when it leads to FDI in China or elsewhere. The same applies to delocalization from Europe.

Accordingly, political concern about delocalization is, to a certain extent, misleading.

Deep integration is generating new transatlantic networks and new economic opportunities[12]. The societies of Europe and the United States are interacting so closely that many of these issues strike at core spheres of domestic governance and are debated as quasi-domestic controversies[13].

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[12] The Atlantic Council of the United States (2004), '*The Transatlantic Economy in 2020: A Partnership for the Future?*', Policy Paper, Washington D.C., November, p. 1.

[13] Cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (2004), '*Partners in Prosperity. The Changing Geography of the Transatlantic Economy*', Center for Transatlantic Relations, Johns Hopkins University–SAIS, p. 166.

Deep integration reaches into traditionally domestic areas and generates frictions on issues such as competition policies, privacy protection, food safety and environmental policy. As economic interaction between both continents steadily intensifies, policy decisions on either side of the Atlantic increasingly affect both American and European businesses, investors and consumers in their operations across national borders and throughout the Atlantic area. Policymakers are thus faced with public demands by important players from outside their traditional interest groups and lobbies.

Moreover, the traditional distinction between internal policies and external policies is becoming less clear. Internal market liberalization also means opening the market to trade and investment. Increasingly, the differences between inward-oriented policies and outward-oriented policies are being erased.

As capital movements have been liberalized, traditional trade protection is becoming obsolete. Protecting industries from external competition requires different instruments. The tool of new protectionism is regulation. National laws prohibiting FDI in certain industries by considering these sectors to be "strategic" are a good example of new protectionism. The lack of clear thought leads to bizarre results such as a country "protecting" itself from foreign physical and technological capital.

The current framework for the transatlantic relationship does not adequately reflect this new reality. Transatlantic deep integration invading traditional areas of domestic regulation has not been properly understood, and the transatlantic policy framework is consequently underdeveloped. A new visionary strategic approach is needed to respond properly to pressing deep integration issues affecting the EU and the US economies, such as competition policies, standardized corporate governance, compatible or common standards and more effective regulatory cooperation.

Up to now, efforts to build a proper transatlantic framework have proved difficult. Multi-year efforts to negotiate sector-specific mutual recognition agreements have resulted in large amounts of time and energy spent on relatively little return. In some areas where MRAs were negotiated, implementation has been poor. The EU-US Positive Economic Agenda and the Regulatory Road Map have not prospered sufficiently, because they have been

taken over by trade negotiators, rather than advanced as part of an overall relationship framed by trade-offs and problem-solving mindsets.

Atlantic leadership is needed, not to challenge or replace multilateral efforts such as Doha with competitive bilateral arrangements such as an EU-US free trade agreement in goods and services, but to dynamize the global economy by energizing Doha globally and implementing a Doha-plus Atlantic agenda.

This second agenda has to be developed. Moreover, not only is this a challenging agenda in its own right, it has become more difficult because of the changing relationship between the Atlantic strategic and economic agendas. For many decades, leaders worked to keep transatlantic economic conflicts from spilling over to damage the core European-American political alliance. Today, the challenge is to make the core economic relationship help avoid Atlantic political disputes.

A wide set of proposals for transatlantic economic relations has developed in recent years and they have recently been drawn up by the European Commission and the US Administration[14].

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[14] Contributions to the 2004-2005 US-EU Stakeholder Dialogue are available at: http://europa.eu.int/comm/external_relations/us/consultation/results/index.htm and http://www.ustr.gov/World_Regions/Europe_Mediterranean/Transatlantic_Dialogue/Section_Index.htm

The following have produced valuable proposals for the consultation process: American Chamber of Commerce; Asociatia Pentru; BdB; BDI; BGA; Blue Silver; Buglife; Bulgariu, Ludmila; BVR-VOED-DSGV; Carson, Philip; Cassar Torregiani; CDI; CEFIC (European Chemical Industry Council); Chamber of Shipping; CIAA; Control Risk Group; Daimler Chrysler; Dales Production; De Groenen; DGAP; DIHK; EPE; ESF; ETUC/AFL-CIO; European Trade Union Confederation/American Federation of Labor-Congress of Industrial Organizations; European Metalworkers' Federation; Expo Cam; FBE; Fédération Francaise; FESE (Federation of European Securities Exchanges); Florin, Irisia; Gates; GDV; HTS Danish Chamber; ICAEW; MEDEF; Media Innovation Unit; Mitchell; Motorola; Revigres Industria; Sanofi-aventis; SC DACO SRL; Sweeney; TABD; TACD (TransAtlantic Consumer Dialogue); Textile Importers Association; The International Precious Metal Institute; UNICE; University of Edinburgh; US Chamber of Commerce; Vasilica Nistor; Verband der Chemischen Industrie and Volvo.

See also OECD (2005), '*The Benefits of Liberalising Product Markets and Reducing Barriers to International Trade and Investment: The Case of The United States and the European Union*', Economics Department Working Paper 432, Paris, June 2005, pp. 7-10.

The Atlantic Prosperity Area proposal aims at defining a deep integration agenda that makes economic sense and that can also win political support on both sides of the Atlantic.

TRADE AND INVESTMENT BARRIERS IN THE TRANSATLANTIC ECONOMY

In spite of the deep integration and great interdependence of the EU and the US economies, the transatlantic economy is still far from having reached its potential. Current barriers in the transatlantic economy result in losses for both European and American citizens. With such barriers in place, companies operating and selling their products in Europe and the United States cannot take advantage of the full benefits of operating in the transatlantic market. They are handicapped in attempts to increase production, do more research and development and product innovation, and streamline operations, and are unable to fully maximise returns on their investments. Transatlantic barriers hinder the potential competitiveness of the US and European economies.

As the OECD states, traditional tariff and non-tariff barriers and regulations that restrict foreign ownership of domestic assets, grant complete or near monopoly status to State-owned enterprises, involve significant regulatory hurdles for prospective FDI, or discriminate between domestic and foreign bidders for projects, are policies that would be expected directly to reduce economic integration across countries.

Moreover, even when domestic regulations do not in principle discriminate between local and foreign firms, they may still distort cross-border integration by affecting the relative prices of different products, or the relative rates of return expected from investing in different locations[15]. In addition, a jointly negative influence on bilateral trade might be expected from cost-increasing or barrier-raising regulations that affect industries in which inputs from both economic areas are needed to produce the traded product. This is the case of many traded services (transportation, communications and business services) in which capital and labour from both the exporting and importing country are used to supply the service. In these situations, it is the

[15] For example, differences in domestic regulations may affect relative production costs and the competitiveness of exporters in foreign markets.

combination of regulations in the EU and the US that is likely to affect trade flows[16].

In short, a quantification of both domestic and outward-focused regulation across the EU and the US is required to assess potential barriers to transatlantic economic integration.

The following paragraphs offer a summary of the kinds of barriers existing in the transatlantic economy[17]. The trend can be briefly described as follows: tariffs and quantitative restrictions have been progressively dismantled, but non-traditional trade barriers have gained ground, in particular through national, supranational and regional regulations dealing with consumer protection, food safety, health, data protection and environmental protection. Non-traditional trade barriers constitute the most durable, opaque, and difficult barriers to deeper levels of economic interaction across the Atlantic[18].

Growing transatlantic economic integration (which is also global) has diverted the centre of attention from what could be called "traditional trade" in goods, including its main instruments for protection (customs, various kinds of quotas) and "defence" (anti-dumping, anti-subsidy and other protection measures) to aspects of internal regulations which affect the activities of foreign companies in domestic markets, in the European market and in the US market. Thus regulations of the various economic sectors, competition law, regulations related to foreign investment, environmental protection, health regulations and consumer rights are gaining increasing importance and becoming key elements for any commercial initiative.

Added to this, the traditional barriers are of relatively slight importance in the transatlantic relationship, except in the agricultural sector and in the

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[16] Evidence of a negative correlation between anti-competitive service regulation and the intensity of service trade is provided in Golub (2003).

[17] See TransAtlantic Business Dialogue, 'Report to the 2005 US-EU Summit: A Framework for Deepening Transatlantic Trade and Investment,' April 2005.

Available at http://128.121.145.19/tabd/media/TABD2005SummitReportFINAL051.pdf

[18] See Center for Strategic and International Studies (2005), '*Test of Will, Tests of Efficacy*', 2005 Report of the Initiative for a Renewed Transatlantic Partnership, Washington, D.C., p. 34

horizontal sphere, in public subsidies and the abuse of anti-dumping and safeguard policies, which are both a major concern. This leads to the logical conclusion that our focus has to be on regulatory barriers and on abuse of defence measures. These kinds of barriers are theoretically justified by what are legitimate objectives for governments, but they often obstruct economic traffic more than necessary in order to reach their goals. At other times, behind these regulatory barriers lie the same causes which were the justification of traditional barriers: the protection of special interest groups who are the beneficiaries of the distortion which results from such barriers.

The situation is further complicated by divergent regulations being produced by separate regulatory and supervisory agencies on each side of the Atlantic, which have developed their rules and regulations in relative isolation and are responsible for entirely separate legal mandates and legislative supervision.

As if this were not enough, additional barriers producing trade distortion are also the result of public decisions. This is the case with public procurement, which protects relevant markets from trade.

Moreover, different standards still persist in many industries.

The 2005 OECD study on transatlantic barriers provides evidence that anti-competitive regulatory stances, or levels of protection, tend to be relatively high in a number of service sectors and in agriculture. This suggests that the broad gains in output outlined above will require very ambitious reforms in these sectors. The sectoral focus of reforms would, however, differ across countries:

1. Competition-restraining regulations in most EU countries would have to be lowered significantly in domestic air, rail and road transportation, electricity and gas, and/or telecommunications. Meanwhile, the US would have to concentrate reform efforts on electricity and rail transport.
2. The important easing of restrictions on FDI in the US would be most noticeable in transport services, while in the EU it would be particularly far-reaching in electricity generation.

3. Reductions in tariff levels in the EU would have to be concentrated on agricultural products; in the US, tariff reductions would imply relatively more adjustment to rates of protection on textiles, apparel and other manufactured goods. It is worth recalling the saying, "the tariff is the mother of the trust".

Trade barriers in agriculture

The most important trade barriers between the EU and US economies are in agriculture. Tariffs, quotas, production subsidies, export subsidies, fiscal subsidies and technical barriers (sanitary and phytosanitary measures, consumer protection measures such as food safety provisions), among other mechanisms, heavily distort agricultural trade between the EU and the US, as well as agricultural trade to third countries.

	Average MFN tariff on goods	Average MFN tariff on agri-goods
US	5%	10.6%
EU	4.2%	17.3%

Source: CEPR (2002)[19]

Both the EU and the US have MFN tariffs on agricultural goods at far higher levels than the average MFN tariffs for industrial goods. The average MFN tariff on agri-goods in the EU is 17.3% and in the US 10.6%. Particularly high rates of protection are applied to rice, sugar and dairy products.

Free agricultural trade in the transatlantic economy would be, no doubt, excellent news. In spite of agriculture being a relatively small sector in both the US and the EU economy, food has an important weight in consumers' baskets, so the positive effects of liberalization would not be negligible. Gains would be much higher if the liberalization resulted from deep structural reforms in public agricultural policies.

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[19] Hylke Vandenbussche, Ian Wooton and Anthony J. Venables, CEPR, (2002), '*Enhancing Cooperation between the EU and the Americas: An Economic Assessment',* London, p. 66.

Trade barriers in manufactures

Trade in manufactures faces less important barriers. However, the higher economic and commercial weight of manufactures means the removal of trade barriers in the transatlantic economy would have a strong positive impact on living standards.

Tariffs on manufactures haven been progressively dismantled. While the average tariffs on trade in manufactures between the EU and the US are low (the average MFN tariff for the EU being 4.2% and for the US 5%), the high volume of trade guarantees that further reductions in tariff barriers will still yield significant benefits. However, tariffs in both the EU and the US are higher on specific products in sensitive sectors, such as textiles, apparel and leather products.

Quotas are an exception as well.

Accordingly, we can say that traditional trade barriers are not a major source of concern in the transatlantic economy when we talk about trade in manufactures.

However, as traditional tariff and quota barriers have been dismantled, other type of obstacles have replaced them in their goal of protecting domestic output from foreign competition. The most important are anti-dumping measures, which very often are nothing but pure protectionist reactions, and technical barriers.

In the food industry, protection measures theoretically enforced to protect consumers (food safety) become powerful trade barriers. Violation of intellectual property rights is an extremely harmful trade barrier for industrial products. Public subsidies are harmful for three reasons. Not only do they cause inefficiency and distort trade, they poison and undermine transatlantic economic relations. Some of the most serious transatlantic trade squabbles, like the Airbus-Boeing case, result from public subsidies, both in Europe and the US.

Apart from the barriers mentioned above, the existence of different standards is also a powerful trade obstacle. Important industries such as the automotive, energy and electronics face these types of barriers.

Trade barriers in services

The EU and US economies are service economies. Transatlantic trade in services is accordingly strong. The service economies of the EU and the US are deeply intertwined in many industries (consultancy, financial services, advertising, IT services). The share of transatlantic trade in services is growing fast[20]. We share the view that service activities are "the sleeping giant of the transatlantic economy"[21].

The reasons for these changes include technical progress, Petty's Law (the shift towards services as the economy develops), outsourcing of services by industrial corporations to achieve efficiency gains, the increasingly service-intensive production of goods, and free-market policies.

Technical progress has dramatically lowered transportation costs for services. Many services were, until fairly recently, non-tradable and required direct interaction between the provider and the customer (e.g. education and financial services). Improvements in technology, especially in computing and communications, have lowered the once-prohibitive technical barriers to trade. Moreover, many services are no longer domestic (e.g. phone assistance, advertising, legal services and consultancy).

And as a result of free-market policies, service industries that were once public monopolies (air transportation, telecommunications, insurance) have been privatized and opened up to foreign competition. Moreover, service-market reforms have led to greater competitive pressures in service markets, pushing firms to seek markets abroad.

Consequently, knowledge-based services in the US and the EU have spread globally, and in particular across the Atlantic.

However, transatlantic trade in services still comprises only around a third of total trade flows, despite services accounting for more than two-thirds of

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[20] Data on protection of services are not as readily available as they are for trade in goods. One of the problems is that it is not always clear how to classify a traded service. Unlike goods, many internationally traded services do not pass through customs. Cfr. Gampson and Snape (1985).

[21] Hamilton, D. and Quinlan, J. (2005), op.cit.

GDP in both areas[22]. The main reason for this is that trade in services faces powerful obstacles as well.

The levels of protection on trade in services have remained high for a number of reasons. One of them is that services have only recently become part of the multilateral agenda. This may, in part, be because the focus on goods began to decline only once free trade in manufactures had been largely achieved.

Barriers resulting from regulations are the most important, and affect a wide range of services. This is true, for example, in the case of professional services. Powerful trade barriers result from the absence of mutual recognition of qualifications, national treatment rules and restrictions to market access (work permits) linked to immigration laws.

Again, harmful and powerful obstacles to commerce result from regulations theoretically envisaged to protect consumers.

There are also obstacles in maritime transport, as well as obstacles resulting from passenger notification rules in air transport. These obstacles result from national security provisions.

As mentioned when we referred to trade in manufactures, different standards are also powerful barriers for transatlantic trade in services. A clear example is mobile communications services, with different technical standards in the EU and the US (CDMA-GSM and WCDMA-UMTS).

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[22] See OECD (2005). In part, the lower trade intensity of services reflects that data on services do not cover all traded service activities. The exchange of services taking place through commercial presence (the activity of foreign affiliates) and movement of individuals (temporary presence of service suppliers) are excluded from balance-of-payments statistics. These omissions, however, are small relative to the gap between goods and service trade intensities, as Nicoletti et al. (2003) state. More importantly, trade in services may be lower than in goods because of higher transport costs. For example, many personal services are not traded between regions within a country, let alone national borders. However, some of the most dynamic service sectors over the past two decades, such as communications, financial intermediation and business services, have lower transportation costs. Moreover, these costs are falling as technical progress in information and communication technologies opens up the possibility of trade in services that were traditionally non-tradeable, such as retail distribution or financial services. See OECD (2001).

Thus benefits from liberalization are potentially very significant[23].

Barriers to transatlantic investment

Investment flows across the Atlantic are large and growing. However, barriers to FDI persist. These barriers take several forms:

— Barriers to foreign ownership, which usually typically take the form of limiting controlling equity stakes by non-residents in domestic companies. Examples of these barriers include airlines in some member countries of the European Union and United States, and shipping in the US.

— Obligatory screening and approval procedures which may also constrain FDI by raising entry costs.

— Restrictions on the ability of foreign nationals to work in affiliates and regulations that nationals or residents must form a majority on the board of directors (for example, in insurance companies of some EU member states).

— FDI flows may be hampered by opaque application of regulatory procedures.

Efforts need to be made on both sides of the Atlantic to ensure that foreign-owned firms enjoy the same regulatory environment as national companies and have access to the same markets. This is particularly important in the service sectors. The EU's Single Market Programme provides guidance on how to proceed in liberalizing these sectors, and lessons learnt from this programme could be usefully applied to EU-US relations.

However, the EU single market approach has proved insufficient to prevent political decisions setting up hurdles or even unbreachable barriers to corporate mergers and acquisitions or privatization processes. This is

[23] Because services are generally intangible and non-storable, they are generally not subject to import tariffs but to other forms of trade barrier. These can take the form of prohibitions, quantitative restrictions (QRs), and government regulation. The QRs are frequently complemented by other measures, limiting the number of firms that may contest a market or controlling the nature of their operations. Cfr. Hoekman (1995).

particularly important in view of the fact that most of the increasing transatlantic FDI activity is driven by ownership changes in existing companies (for example, through mergers and acquisitions and privatizations), rather than so-called "green-field" investment, where new production plants are built (OECD, 2002).

Intra-European mergers and acquisitions have been blocked or dissuaded through neo-protectionist government decisions. The same has happened to transatlantic M&A deals. What is worse, some EU governments are planning to block foreign M&A in "strategic sectors" by law. This a particularly damaging neo-protectionist threat to the transatlantic economy, as it strikes at its core: transatlantic investment.

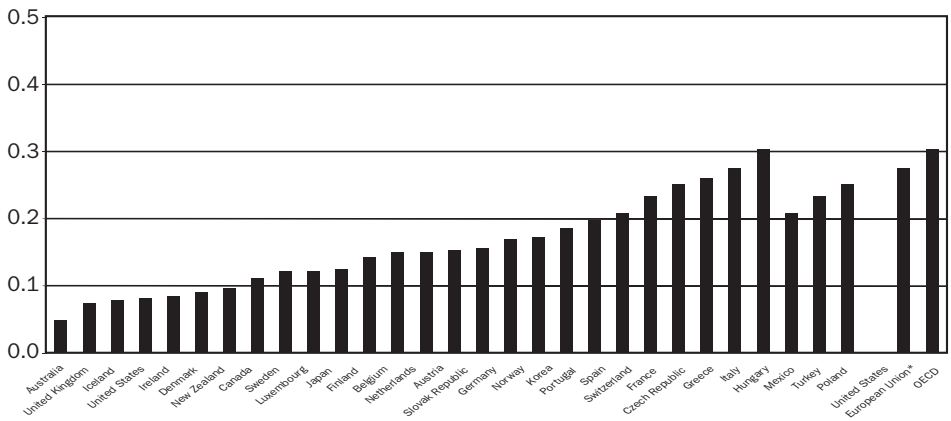
More effective measures are required to remove these harmful barriers to transatlantic investment.

OECD indicators of FDI restrictions suggest that, at the aggregate level, FDI barriers tend to be slightly lower in the European Union than in the United States[24]. The low restrictions recorded for the EU member states, however, reflect largely the absence of barriers to intra-EU FDI, and only to a lesser extent openness to non-EU countries. The United Kingdom has the lowest FDI barriers in the EU and in the OECD, owing to a particularly permissive regime on foreign ownership of domestic assets.

Graph 3.5. includes the set of OECD indicators showing the limits set by various countries to foreign direct investment. Value 0 in the indicator represents a complete absence of restrictions, while value 1 indicates a maximum level of restrictions For the methodology, see the OECD website.

[24] The OECD (2005) highlights the difficulty in accounting for some forms of FDI restriction such as screening and approval procedures in a numerical indicator of FDI restrictions.

Graph 3.5. OECD indicators of FDI restrictions (2001)1



1. The indicators range from 0 (least restrictive) to 1 (most restrictive)
* EU 15 (simple average)
Source: OECD, Golub, S. (2003)

Horizontal barriers

Horizontal barriers are those affecting trade and investment across the board. They include public subsidies, protectionist regulation such as abuse of the anti-dumping clause, invocation of serious injury to domestic industry and government procurement policies, as well as obstacles resulting from costly and time-consuming procedures to acquire business visas, resulting from national security provisions.

Different accounting standards are an indirect but prominent obstacle to transatlantic trade and investment. The same could be said of regulatory provisions dealing with corporate government. In the field of electronic commerce, regulation of data protection is also a source of powerful trade barriers.

Given the size of government, rules allowing for an exception to general competition rules when it comes to public procurement are extremely harmful barriers to transatlantic trade, as they exclude the potential provision of goods and services by companies located in the other side of the Atlantic.

Other factors worth mentioning are decisions made by anti-trust and competition authorities, independent regulators and courts. These decisions sometimes deliver harmful commercial protection.

TRADE DISPUTES

Practices such as public subsidies, abuse of the anti-dumping clause and invocation of serious injury to domestic industry have given rise to countless trade disputes between the EU and US, which though affecting a minimal part of trade still give rise to political aggravation. Though EU-US trade disputes only amount to 1-2% of the transatlantic economy, they often make the headlines.

The transatlantic trade atmosphere has been unsettled by cases such as the subsidies granted by the Foreign Sales Corporations, Microsoft, GMOs, hormone-treated beef, bananas, the Byrd Amendment on the distribution of countervailing tariff revenues, steel, and the conflict over subsidies to Boeing and Airbus.

Moreover, disputes fuel resentment, hurt innocent companies in the long run and attract resources which would be better allocated to increased cooperation.

THE CONFLICT OVER BANANAS

The conflict over bananas is an example of a trade conflict between the EU and US which has been badly handled and which has been dragging on for too many years.

The conflict began in 1993 when the EU harmonized what had been different national regimes into one single Community regime. The new regime led to protests from the Latin American (above all Ecuador) and US producers (multinationals based in the US), who considered that it was protectionist. This led to a conflict leading to intervention by the WTO and to a trade war between the EU and US. The WTO finally ruled against the protectionist regime of the EU and authorized the US to apply sanctions (the well-Known carousel sanctions), which ended up penalizing sectors

which had nothing to do with the issue, and aggravating and escalating the conflict.

In 2001 a gradual change was agreed with a mixed system of quotas and tariffs lasting until 2005, and a tariff-only system from 1 January 2006. The conflict revived when the EU set the tariff level at 230 euros per tonne, which the exporting countries considered abusive. The WTO ended up penalizing the EU again in July 2005 for excessively high tariffs.

The European Commission decided in September 2005 to reduce the tariffs on American bananas by 20% and apply a single tariff of 178 euros per tonne (substituting the tariff of 75 euros per tonne in the quota system), in an attempt to end the conflict. The ACP countries with a preferential regime have a tariff-free quota of 775,000 tonnes from January 2006, compared to the present figure of 750,000 tonnes.

To sum up, this is a trade conflict has been dragging along for more than twelve years, and helped sour trade relations between the EU and US. It could have been avoided altogether.

We may distinguish between *traditional* trade disputes, dealing with tariffs and trade defence measures (for example, safeguard measures on steel), and new types of dispute that could be called *regulatory conflicts*. These are much more complex and difficult to settle, as they result from domestic law passed democratically and dealing with politically sensitive areas (for example, hormone-treated beef).

Though traditional trade disputes may be solved in a relatively simple way through mutual consultations or by means of the WTO dispute settlement mechanism, regulatory conflicts are much more difficult to solve. Regulatory cooperation mechanisms are required, with appropriate procedures for mutual consultations and exchange of information, studies on the trade impact of domestic legislation and mutual recognition agreements.

Even when some of these disputes have been settled in law through the WTO there is no guarantee that the solution will be applied politically. This demands an examination of different remedies under WTO rules.

Procedures under WTO rules

In the Atlantic Prosperity Area the hugely complicated procedures set up by the WTO to counter the effect of harmful practices in the form of public subsidies, so-called dumping, and serious injury, would have to be applied.

In order to impose countervailing duties the following circumstances must be found to exist:

— *Proof of the harmful practice:*

1. *Subsidization*: a financial contribution by a government which confers a benefit upon the exporting company;

2. *Dumping*: determining the positive dumping margin measured by the excess price charged by the defendant firm in its domestic market over what it charges in the market where dumping is said to have taken place;

3. *Serious injury*: establishing that imports at low prices or in large quantities cause serious injury to one or a number of domestic industries.

— Material injury or a threat thereof to the domestic industry producing a similar product.

— A causal link between the action and the injury.

— General interest in the imposition of the measures (considerations of the interests of users, consumers, and upstream and downstream industries).

The chain of analysis and proof implied in this procedure is most laborious. The average period for coming to a decision has been 13 months for anti-subsidy procedures and 15 months for anti-dumping procedures. Safeguards can be unilaterally imposed by the harmed party and last for a maximum of five years. The steps are complaint, a questionnaire, an injury submission, verification visits, sampling of prices and imports, hearings, lobbying,

preliminary determination, findings, reviews and refunds, expiry reviews. In parallel, verification is carried out by the Commission so that the countervailing tariffs are passed on to the customers and are not circumvented.

Trade remedies against public subsidies, dumping, and serious injury[25]

The results of this Byzantine procedure are as follows. In the case of export subsidies, countervailing duties may be imposed by countries harmed and subsidies must be phased out by erring nations in the course of five years. Anti-dumping tariffs may be imposed by countries suffering from price discrimination, after following a set procedure. Safeguard measures can only be imposed for a five-year period.

Nations at different stages of development are treated differently. Some of the poorest nations are exempt from the prohibitions on government subsidies, while other developing nations are given eight instead of five years to phase out subsidies. As far as anti-dumping is concerned, dumping nations, when underdeveloped, can try to offer "constructive remedies", in the form of accepting a lower duty or offering a price undertaking. Finally, developed nations must not take measures against very small exporters with regard to safeguards, while developing nations can in turn keep safeguards for eight years rather than only two.

The early warning mechanism

The 1999 EU-US Summit agreed on a set of *early warning principles*, using the existing mechanisms established under the New Transatlantic Agenda (NTA) and the Transatlantic Economic Partnership (TEP)[26], to help the EU and the US identify and prevent potential bilateral conflicts and facilitate their resolution before they risk undermining the broader EU-US relationship.

The *early warning mechanism* has not produced the expected results, that is, has not prevented disputes from arising and has not allowed dialogue on

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[25] GATT Treaty of 1994, Art. VI, the Agreement on Subsidies and Countervailing Actions (SCM Agreement), the Anti-Dumping Agreement (ADA), and the Agreement on Safeguards.

[26] See next chapter.

sensitive issues at an early stage. Disputes continue to increase and cases are filed in the WTO without full recourse to the bilateral procedures in place.

THE EARLY WARNING MECHANISM

An EU-US agreement at the Bonn Summit on 21 June 1999 set out a series of principles aimed at ensuring the identification and prevention of potential trade disputes at an early stage before they escalated politically and legally. Early warning is intended to improve the capacity of each side to take the others side's interests into account at an early stage when formulating policy, legislative, or regulatory decisions, without limiting each side's existing decision-making autonomy.

The TEP Steering Group serves as the forum for dealing with potential trade and investment-related problems, and the NTA Task Force as the forum for other potential problems. In addition, the various transatlantic dialogues have been invited to contribute by identifying problems and offering proposals for resolution at the early warning stage.

In October 2000, the Commission Services undertook an evaluation of the TEP, which was then discussed with member states in the 133 Committee. The evaluation concluded that, despite inherent difficulties in ensuring the timely implementation of the Action Plan, "the TEP has proven a useful vehicle for the further development of transatlantic cooperation in trade and investment." The TEP aims at preventing disputes from escalating and in accelerating activity in areas of mutual interest e.g. regulatory cooperation (bilateral) and WTO accessions (multilateral). Efforts are concentrated on the means of prioritizing and structuring dialogue in order to ensure a higher rate of positive results, and prevent failures experienced in certain sectors in the past.

WHY EXCHANGE RATES MATTER LESS THAN IT SEEMS

Many analysts emphasize the role of the euro-dollar exchange rate (the USD-DEM at the time the former European ERM existed) when discussing the transatlantic economy and potential threats to it.

We think this is a mistake. Exchange rates matter less than many people think.

This does not mean that exchange rates have no influence on trade flows. They do, and it would be very strange if it were otherwise. What we mean is the fluctuations in the exchange rate between the euro and dollar are not a driving force of transatlantic trade.

The evidence is clear. For many years, US imports from the EU have surged despite the strong appreciation of the euro against the US dollar. The reverse is also true. EU imports from the US have jumped in periods during which the dollar has appreciated strongly against the euro. In both cases, imports of the area with a depreciating currency increased at higher rates than its reciprocal exports[27]. This is what happened in 2003 and 2004.

Conventional international monetary economic theory seems to be wrong in this case. Is there an explanation for this? We think that there is.

First of all, more than 50% of transatlantic trade is intra-firm trade. Related-party trade is not responsive to exchange rate fluctuations, but it is certainly dependent on domestic demand. This means that when the US grows strongly, EU affiliates in the US produce and sell more, and demand more from the parent company, no matter what the exchange rate is. As a result, US imports, and EU exports to the US, surge. This also explains why even large shifts in the dollar-euro exchange rate do not generate protectionism.

In addition, we also believe that foreign-exchange futures and options seem to be efficient hedging tools.

The first policy conclusion is that coordinated intervention on the exchange rate by central banks would be greatly ineffective. We know that this point of view is controversial. Professor Mundell, for example, has recommended active intervention on the dollar-euro exchange rate[28]. However, we think clean

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[27] Hamilton, Daniel S. and Quinlan, Joseph P. (2004), '*Partners in Prosperity.The Changing Geography of the Transatlantic Economy*', Center for Transatlantic Relations, Johns Hopkins University–SAIS.

[28] Robert Mundell (2004), '*The international monetary system in the 21st century*', closure speech of 2004 Campus FAES, Navacerrada, Madrid, July.

floating rates are better than dirty flotation. Let's leave the Fed and the ECB out of the dollar-euro exchange rate.

The second policy conclusion is that the main mechanism to rein in the US current-account deficit is not the dollar-euro rate, but an increase in global interest rates, which are at historically low levels and induce low rates of saving and high levels of indebtedness in many countries.

CHAPTER 4.
THE BARRIERS IN THE TRANSATLANTIC ECONOMY

WHY HAVE BARRIERS AT ALL?

The advantages of liberalizing trade and investment are widely and increasingly understood. This is reflected, amongst other things, in the massive decline in average tariffs in the latter half of the twentieth century.

Yet some areas of economic activity are still highly protected by a range of barriers. Why do governments decide to exclude particular areas of economic activity from foreign competition?

"Economic arguments" (fallacies) supporting protectionist policies

A widespread (and, in our opinion, unfounded) argument states that protection may be "legitimate" if the particular industry is the source of externalities for other economic activities. Thus, protection may be warranted by the government if the sector "generates spillovers in research and development to other sectors of the economy that could otherwise be captured by foreign firms". We believe this weak and pseudo-academic argument is a fallacy which is being used as an excuse to deliver protection.

More dangerously (remember the positive theory of international trade), protection may also be warranted if lobbies are able to persuade the government using these fallacies or alternative instruments.

The strongest proponents of protection during the latter half of the twentieth century were development economists. They argued that secular

deterioration in the relative prices of commodities (terms of trade) would be harmful to many developing nations and advocated that such nations should industrialize behind a protective wall of tariffs.

While these arguments generally found disfavour in the 1980s and 1990s, there was something of a resurgence in the late 1990s due in part to the Asian crisis in which the apparent triumph of export-oriented trade strategies was less obvious than previously believed. Further, there has been a perception in much of the developing world that the trade liberalization of the past half century has been predominantly in the interests of the industrialized countries, who have retained barriers against imports in many industries. This has prevented the evolution of comparative advantage and the industrialization of developing countries that might, as a result, be resistant to further trade liberalization themselves.

However, the impressive surge of China, India, South Korea and other Asian economies following the 1997-1998 currency adjustment has lowered the intensity of those voices.

"Social arguments" (fallacies) supporting protectionist policies

Free trade and investment provide overall welfare gains, but they involve resource re-allocation and thus long-term as well as short-term side effects.

Contraction of an industry in a country as a result from it opening up to trade may have social (and political) implications for a certain region, due to the geographic concentration of the industry's activities (remember the Stolper-Samuelson theorem). Protection might then be introduced as a "temporary safeguard" for these jobs.

The problem is that, once delivered, protection is never (or almost never) temporary. The Multi-Fibre Arrangement, established as a "voluntary export restriction agreement", providing a "temporary protection" to the textile industry of developed economies, together with the preceding LTA, has lasted for more than 40 years.

THE MULTI-FIBRE ARRANGEMENT (MFA) ON INTERNATIONAL TRADE IN TEXTILES. HOW TEMPORARY PROTECTION BECOMES PERMANENT

The Multi-Fibre Arrangement was an internationally agreed derogation from GATT rules allowing an importing signatory country to apply quantitative restrictions on textile imports when it considers them necessary to "prevent market disruption" (in fact, to protect the domestic market from imports), even when such restrictions would otherwise be contrary to GATT rules. MFA rules provided that quantitative restrictions should not reduce imports to levels below those of the preceding year, and should, if continued, permit trade to expand by specified percentages. Since an importing country could impose such quotas unilaterally to restrict rapidly rising textiles imports, most important textile-exporting countries considered it advantageous to enter into bilateral agreements with the principal textile-importing countries.

The MFA came into effect on 1 January 1974 and succeeded the Long Term Agreement on International Trade in Cotton Textiles (LTA), which had been in effect since 1962. Whereas the LTA applied only to cotton textiles, the MFA also applies to wool, man-made (synthetic) fibres, and silk blend and vegetable fibre textiles and apparel products.

The MFA was renewed in December 1977, December 1981, July 1986 and again in July 1991.

The global system of bilateral textile and apparel quotas comprising the MFA was scheduled to come to an end in 1994, with a 10-year phasing out period. Under the Uruguay Round, countries agreed to eliminate the MFA quotas in phases to begin 1 July 1995 and to end 1 July 2005.

After the 10-year transition period, rules on textile trade have been fully integrated into the general rules of the World Trade Organization set up under the Uruguay Round accord.

In all, the LTA-MFA agreements have lasted for 43 years.

Non-economic arguments supporting protection

Protection is sometimes promoted for "non-economic" reasons. It may be argued that a particular industry (for example, coal, or agriculture) is "essential" or "strategic" in that a continued supply of the product is necessary even when there is a dislocation of trade in cases such as war, catastrophe, etc.

In addition, particular industries may be considered "important to a nation's culture". Consequently, their decline (resulting, for example, from foreign competition and social preferences) may be thought detrimental to the overall well-being of the country.

The reality behind these arguments

The reality is much simpler. All these arguments usually hide the interest of pressure groups which want to keep markets protected from competition and get subsidies from the government, i.e. from the pockets of the rest of taxpayers. The general rule behind protectionist arguments is simply a desire to preserve or increase oligopolistic or monopolistic rents.

As a result of the powerful action of these lobbies, there still are many different types of transatlantic barriers, both traditional tariff barriers and more importantly non-tariff barriers.

All these barriers pursue the traditional goal of protectionist measures: reduction of foreign competition in trade, restriction of foreign ownership of domestic assets, oligopolistic or monopolistic market power to private or State-owned companies and discrimination between domestic and foreign bidders for projects.[1] The final result is, of course, extra revenues for a minority and losses for the majority.

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[1] As the OECD (2005) points out, even domestic regulations that do not in principle discriminate between local and foreign firms may still distort integration by affecting the relative prices of different products. Moreover, a jointly negative influence on bilateral trade might be expected from cost-increasing or barrier-raising regulations that affect industries in which inputs from both countries are needed to produce the traded product. This is the case of many traded services in which capital and labour from both the exporting and importing country are used to

Some of these barriers, such as export subsidies, are outlawed by international treaties[2], but unfortunately some other protectionist moves are aided and abetted by international regulations. Examples are procedures for countervailing tariffs against dumping, or safeguard measures against the sudden massive arrival of foreign goods.[3]

TRADITIONAL TRADE BARRIERS: TARIFFS

Happily, EU-US tariffs are generally low, averaging between 3%-4% on annual trade of around €500 billion, although they are higher on products in sensitive sectors.

Overall applied bilateral tariff levels for the European Union, the United States and other OECD countries are set out in Figure 4.1.

The highest tariff barriers to trade between the two regions are in agriculture. The average MFN tariff on agricultural goods in the EU is 17.3%. The average MFN tariff on agricultural goods in the US is 10.6%.[4]

The average tariffs on trade in manufactures between the EU and the US are low: the average MFN tariff for the EU is 4.2% and 5% for the US.

US tariffs on primary goods from Europe overall are low. Tariff levels in the group of food and clothing overall are higher than on primary goods. The US has relatively high tariffs on European sugar exports.

The highest EU tariff barriers are found in the food and clothing category, where European tariffs are particularly high on imports of sugar and of processed foods coming from the US.

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supply the service. In these situations, it is the combination of regulations in the countries involved in the transaction that is likely to affect trade flows. Evidence of a negative correlation between anti-competitive service regulation and the intensity of service trade is provided in Golub (2003). In short, a quantification of both domestic and outward-focused regulation across countries is required to assess potential barriers to economic integration.

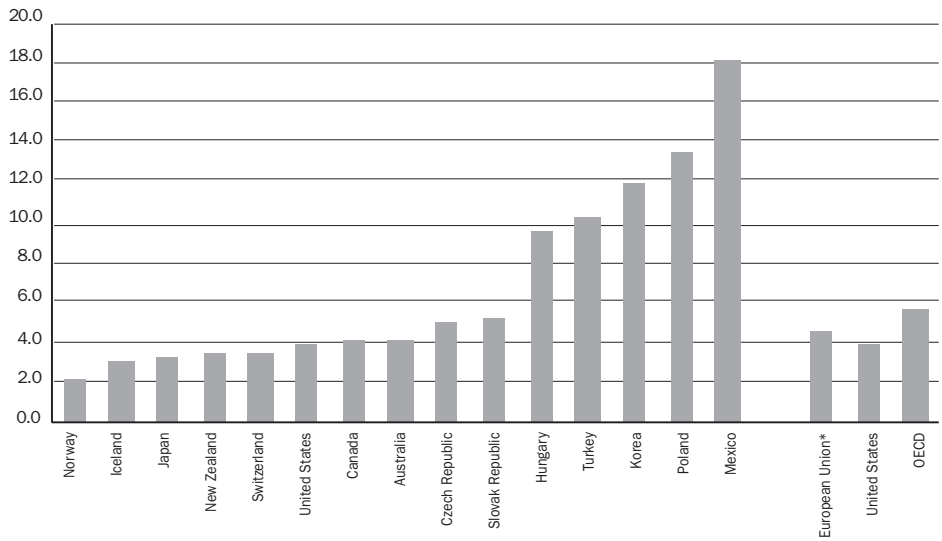
[2] GATT 1994, art. VI, and WTO SCM Agreement.

[3] GATT 1994, Art. VI and XIX, and WTO ADA and Agreement on Safeguards.

[4] Centre for Economic Policy Research (2002), "Enhancing Economic Cooperation between the EU and the Americas. An Economic Assessment", London, May.

Though the best measure of protection is real rather than nominal protection, tariffs are often used as proxies. As Graph 4.1. shows, average nominal tariff levels in the European Union and the United States are relatively low. However, tariff levels in the European Union are more widely dispersed than those in the United States, and in both areas simple average tariff rates mask higher rates of protection on certain tariff lines and the impact of preferential trade agreements[5].

Graph 4.1. Applied % tariff levels in the EU, US and other OECD countries, 2003



*EU 15
Source: OECD

To provide an indication of tariff variation in the EU and the US, trade-weighted *ad-valorem* equivalent measures of applied protection for agricultural and manufacturing products are presented in next table[6].

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[5] Cfr. Nicoletti et al. (2003). The MFN tariff rates are ad valorem and do not include specific tariffs. The latter are frequently used on agricultural and food products with effects that are both less transparent and often more restrictive than ad valorem duties. MFN tariff rates also do not include preferential tariffs, the importance of which has been growing in recent years with the expansion of regional trade agreements. The recent trends in MFN tariff protection reflect reductions agreed in the Uruguay round, with some differentiation according to sectors.

[6] Trade-weighted tariffs still understate the protection barriers, as trade will tend to be lower for goods and services with high tariffs.

Table 4.1. Ad-valorem equivalent measures of applied border protection in the US and the EU (2001)

	United States		European Union	
	On total imports	On imports from EU15	On total imports	On imports from US
Paddy rice	3.6	4.5	36.7	73.6
Wheat	0.2	2.5	0.2	1.3
Cereal grains	0.0	0.0	4.2	7.8
Vegetables, fruit, nuts	0.6	2.7	7.0	4.4
Oil seeds	2.9	6.5	0.0	0.0
Sugar cane, sugar beet	0.2	0.2	5.6	0.0
Other primary agriculture	1.7	1.9	1.1	8.9
Bovine cattle, sheep, goats, horses	0.0	0.0	3.5	0.7
Natural resources	0.0	0.0	0.0	0.0
Bovine cattle, sheep and goat meat products	2.8	1.4	13.5	19.8
Meat products	0.6	1.1	3.1	24.4
Vegetable oils and fats	1.0	1.2	4.0	5.2
Dairy products	18.2	20.0	3.0	32.0
Processed rice	4.4	6.5	51.5	93.8
Sugar	25.4	23.4	62.9	23.2
Other food products	2.5	5.3	3.0	15.3
Beverages and tobacco products	1.4	1.5	1.4	8.3
Textiles	7.9	8.5	1.8	6.4
Wearing apparel	9.9	10.1	3.2	10.1
Leather products	12.2	7.4	2.8	4.5
Other manufacturing	1.0	1.6	0.5	1.7
Agriculture average[a]	1.1	2.8	2.8	13.1
Manufacturing average[a]	1.9	1.9	0.7	2.1

[a]. Denotes trade-weighted average
Source: OECD; GTAP (version 6.05)

Tariff rates on textiles, wearing apparel and leather products are well above the average protection levels for manufacturing both in the United States and in the European Union.[7] In agricultural trade, a number of product categories have

[7] Cfr. OECD (2005), "*The Benefits of Liberalizing Product Markets and Reducing Barriers to International Trade and Investment: The Case of The United States and the European Union"*, Economics Department Working Paper 432, Paris, June. Cfr. Transatlantic Business Dialogue (2005), "*Report to the 2005 US-EU Summit: A Framework for Deepening Transatlantic Trade and Investment*", April.

Available at http://128.121.145.19/tabd/media/TABD2005SummitReportFINAL051.pdf

relatively high tariff protection levels, including rice products, sugar, meat products and dairy products. Furthermore, for both agricultural and manufacturing products, average rates charged on EU-US trade tend to be higher than averages calculated for total imports from all destinations. This suggests that despite generally low tariff levels, EU-US trade is affected disproportionately.[8]

When non-tariff forms of protection are considered (safeguard clauses, anti-dumping measures, countervailing duties), the assessment of the total cost of protection is substantially increased.[9]

NON-TRADITIONAL BARRIERS: THE "THREE WALL SYSTEM"

As the OECD rightly highlights, non-tariff measures (NTMs) were traditionally associated with a restricted number of barriers enforced at the border. Currently, NTMs encompass both border and behind-the-border measures.

Non-tariff border measures

Quantitative controls such as quotas and voluntary export restraints were mostly abolished at the time of the implementation of the Uruguay Round results. Within the European Union and the United States, price control NTMs mainly consist of trade remedies. Although these trade remedies are meant to be distortion-correcting rather than distortion-creating, at times NTMs may instead divert trade and protect local producers. Other remaining border NTMs are generally applied to protect morals, public health and security. In some cases, customs procedures and rules of origin applied by the European Union and United States are trade-restrictive.

Non-tariff behind-the-border measures

Behind-the-border NTMs encompass regulatory measures, government procurement procedures, subsidies and other aids for production, domestic

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[8] Differences between tariff levels for total imports and tariff levels on EU-US trade reflect both different levels of tariff protection and differing trade structures.

[9] According to the CEPR (2002), for example, contingent protection accounted for 30% of the total cost of protection.

tax measures, competition policy, intellectual property rights, investment-related measures, and, to a lesser extent, State trading entities. Regulatory measures include national environmental, safety, health and administrative regulations, standards and technical regulations for industrial products as well as sanitary and phytosanitary measures.

Countries have the legitimate right to adopt any measures they deem appropriate as long as they do not discriminate between domestic and foreign producers and obey WTO rules. EU and US policymakers can help prevent non-tariff trade measures from becoming non-tariff trade barriers by ensuring that NTMs are non-discriminatory, transparent, and applied with efficient administrative procedures.

While many of the measures (such as technical barriers to trade, sanitary and phytosanitary measures) are de facto applied at the border and thus perceived as border NTMs, they are directly linked to domestic policies and applicable to both domestic and imported goods. On both sides of the Atlantic such measures cause concern when they are not transparent and involve burdensome and costly testing, certification and inspection procedures, packaging and labelling requirements, or exceed international recommendations. For many of these NTMs, it is difficult to determine their degree of trade restrictiveness. However, to a significant extent, behind-the-border NTMs are included by indicators of anti-competitive product market regulations such as the *discriminatory procedures indicator* (Conway et al, 2005).

Where the barriers are: the “three-wall” protection system

Thus tariffs and traditional quantitative restrictions are not the major impediment to trade. As tariffs have declined, they have been supplanted by a three-wall protection system consisting of a) control over FDI, b) State control, and c) other barriers. All of these undermine the achievements of WTO negotiations. The other barriers referred to include quota protection (anti-dumping, countervailing duties, and safeguard measures), anti-dumping policies, public subsidies, government procurement policies and regulations. Active anti-dumping cases and squabbles dealing with public subsidies are especially harmful. Regulatory barriers to trade in goods and services are key.

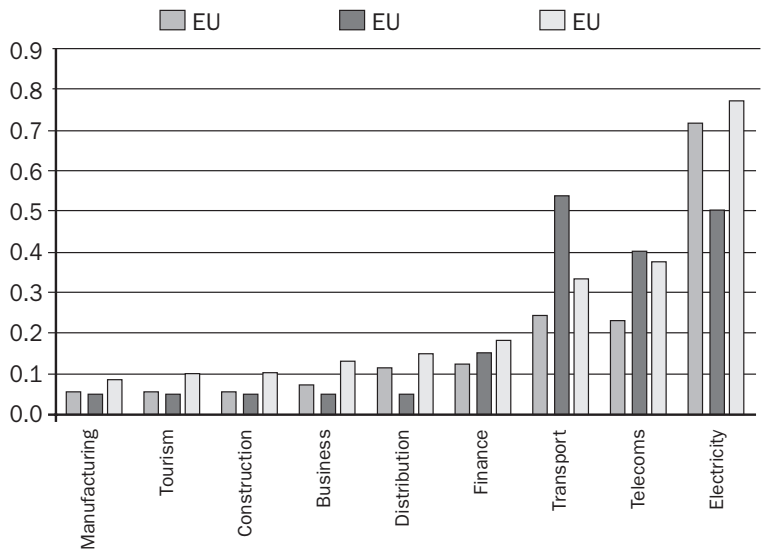
These include safety norms, different health and environmental rules and different standards, but also public subsidies, anti-dumping policies, anti-trust policies and decisions by regulatory bodies. These are the powerful, opaque and durable tools of neo-protectionism.

The first wall of protection: control over inward FDI

If a Government wants to deliver protection to a certain industry, control over inward FDI is a powerful instrument. It is quite obvious that if FDI is impeded, foreign competitors simply do not have any chance.

According to the OECD studies, FDI controls on manufacturing are low in both the US and the EU. In Europe, sectoral barriers to FDI appear highest in transport services, telecommunications and above all electricity. FDI restrictions on transport services and telecommunications are higher in the US than in the EU on average. While electricity restrictions are also high,

Graph 4.2. Barriers to FDI in the EU, the US and OECD countries (2001)



Note: The indicator ranges from 0 (least restrictive) to 1 (most restrictive).
Source: Golub, Stephen (2003), "Measures of Restrictiveness on Inward FDI in OECD Countries", OECD Economic Studies No. 36, OECD, Paris.

they are lower than the levels of most European countries[10]. The next figure shows the intensity of protection against FDI according to the OECD's methodology.

The second wall of protection: State control

Another effective way of protecting certain industries from foreign competition is public ownership. High levels of State ownership in certain sectors of the economy are a powerful barrier to foreign investment flows to the extent that the State has effective equity-controlling stakes. This is particularly important in regulated sectors where public ownership over incumbent companies is common.

It is a very relevant, and sensitive, issue in the electricity and telecommunications sectors in several European countries.

Protection can also be implemented indirectly, i.e., not only through State holdings, but also through State-owned industrial companies or financial institutions holding controlling stakes on other companies. Central, regional and local governments might be the ones responsible for these types of obstacles through their public or pseudo-public corporations.

The third wall of protection: other barriers

If foreign competitors manage to scale the two previous walls, they are still faced with a third protectionist wall: asymmetric regulation and restriction to market access. Efforts need to be made on both sides of the Atlantic to ensure that foreign-owned firms face the same regulatory environment as domestic companies and have access to the same markets. This is particularly important in the service sector.

The OECD has codified a comprehensive range of regulatory barriers to competition into indicators of the overall stance of product market regulation

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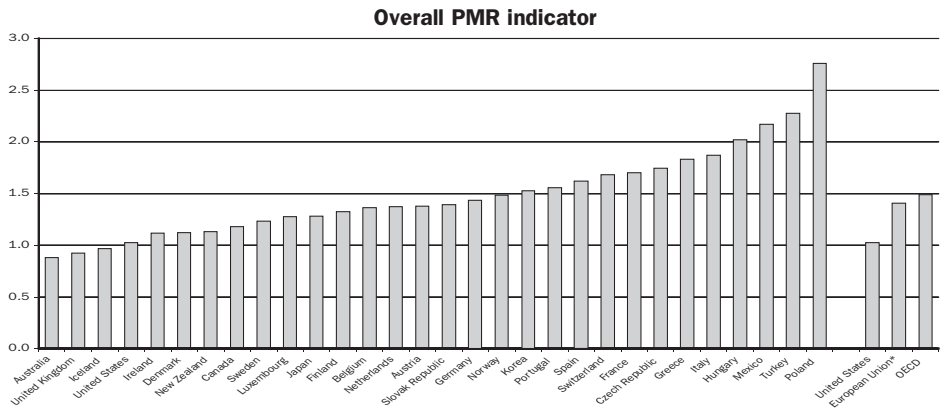
[10] Cfr. Golub, Stephen (2003), "*Measures of Restrictiveness on Inward FDI in OECD Countries"*, OECD Economic Studies No. 36, OECD, Paris.

(PMR) as at the end of 2003[11]. The overall indicators of PMR[12] for OECD countries are shown in graph 4.2. PMR encompasses both outward-oriented barriers (the "first wall of protection") and inward-oriented barriers (the second and third walls). High-level indicators of the regulatory burdens imposed by inward-oriented policies only are also shown in graph 4.2.

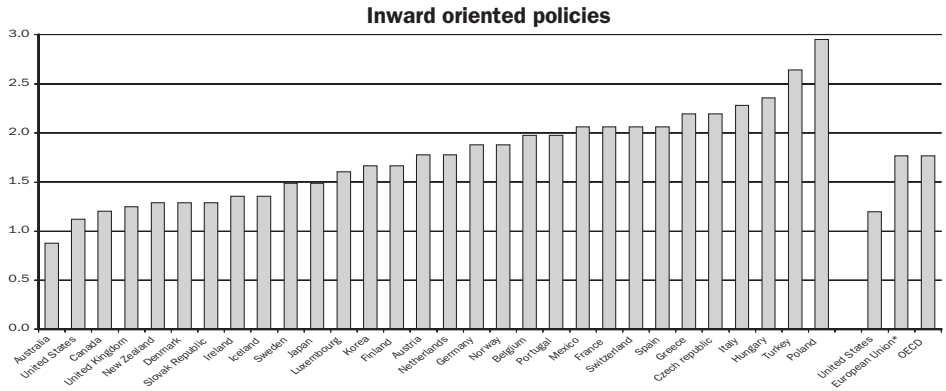
The OECD PMR indicator shows that regulations are more constraining for competition in the European Union than in the United States. The differences are larger still when the focus is on inward-oriented regulations. Graph 4.3 shows the figures for this PMR indicator in OECD countries.

Graph 4.3. Product market regulation indicators in the OECD (2003)[1]



[11] The PMR indicators are based on a broad survey of economy-wide and industry-specific structural policy settings. The methodology developed to summarize the broad range of information involved in constructing the PMR indicators is first described in Nicoletti *et al.* (1999). The update of the indicators to take into account regulation at the end of 2003 is discussed in Conway *et al.* (2005). In general, the cross-country outcomes of the PMR indicators are largely in line with more "subjective" surveys of regulation and the business environment. See Nicoletti and Pryor (2005).

[12] As the OECD highlights, high PMR scores indicate that a country has a relatively restrictive set of product market regulations, while low PMR scores suggest that the regulatory environment is more conducive to competition. Importantly, low scores do not necessarily indicate that there is less regulation in the economy overall. For example, regulations that serve important and legitimate social objectives, such as those covering health and safety standards and the environment, are not included.

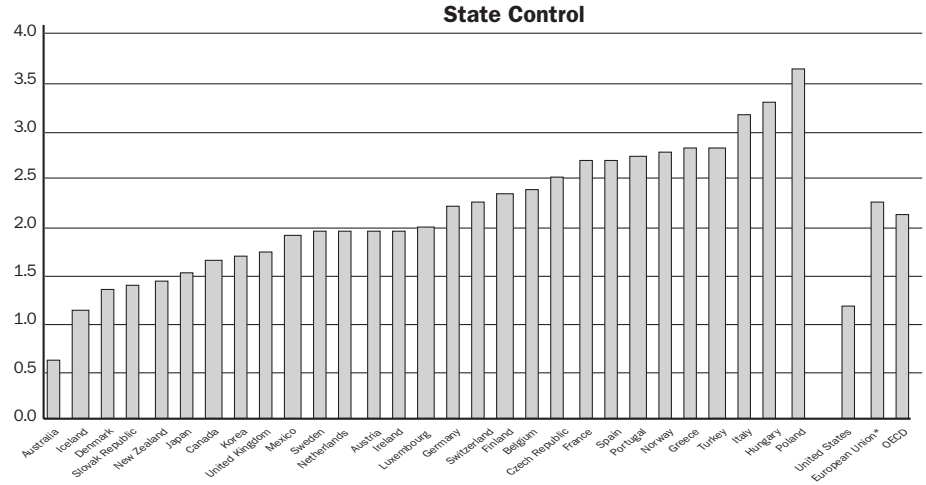


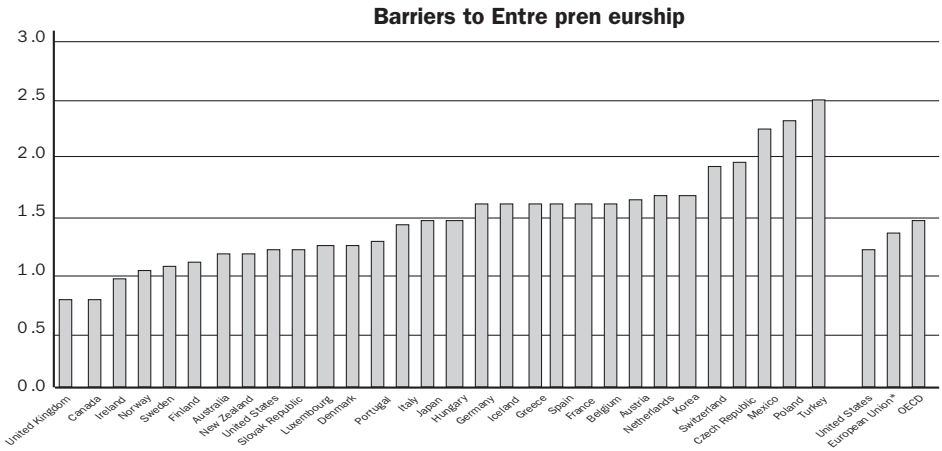
The indicators ranges from 0 (least restrictive) to 6 (most restrictive).
*EU 15 (simple average)
Source: OECD, Conway et al. (2005)

The inward-oriented regulations can be broken down into those producing restraints due to State control and those producing barriers to entrepreneurship (graph 4.4). Restraint due to State control is noticeably higher in the European Union than the United States, and is driven by higher levels of State involvement in business operations[13]. According to the OECD, barriers to entrepreneurship are also lower in the United States than in the European Union on average, reflecting less regulatory and administrative opacity, lighter administrative burdens on start-ups and lower barriers to competition.

[13] This means a greater use of command and control regulations, such as regulations of shop opening hours, and universal service requirements on telecoms, air and rail networks.

Graph 4.4. Indicators of state control and barriers to entrepreneurship in the OECD, (2003)[1]





The welfare costs of this protection cannot be easily quantified, especially regarding trade in services[14], but they are considerable.[15]

These types of non-traditional trade hurdles find a fertile ground for growth in the service sector.

PROTECTIONIST REGULATION

Protectionist regulation consists largely of domestic regulations establishing effective obstacles to trade and investment.

First generation regulatory barriers include safety norms, different health and environmental standards, different technical standards and public procurement laws. Very often, such barriers are the result of lack of coordination or inadequate information exchange between regulators and legislators. Sometimes, however, they are no more than less-visible protectionist measures.

Second generation regulatory barriers are much more difficult to deal with, and frequently perverse. Public subsidies, anti-dumping policies, anti-trust policies and decisions of regulatory bodies are powerful, opaque and durable tools of neo-protectionism.

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[14] As mentioned before, because services tend to be intangible and non-storable, they are generally subject to trade impediments in the form of prohibitions, quotas or quantitative restrictions (QRs), and government regulations such as those limiting the number of firms that may contest a market or controlling the nature of their operations. See OECD (2005).

[15] When QRs are used in goods trade, it is easy to convert them into a *tariff equivalent*. An import quota drives up the equilibrium price. The increase in the price as a result of the quota is the tariff equivalent, as the same outcome as the QR could have been achieved by directly taxing imports at this rate. Ideally, we would like to generate similar tariff equivalents to calculate the restrictions countries impose in services trade. However, the multidimensional nature of these restrictions makes it extremely difficult to generate such measures. See Hoekman (1995). Given the unavoidable arbitrariness of the benchmark tariff equivalents due to the absence of data on barriers to trade, it is very difficult to quantify the benefits to liberalization of trade in services.

HORIZONTAL BARRIERS

Serious injury to domestic industry. Safeguard provisions

Safeguard actions are undertaken when imports at low prices or in large quantities cause "serious injury" to one or a number of domestic industries. These situations can arise without any unfair practice on the part of a foreign government, or even of a private exporter from another country[16].

The recourse to safeguard clauses is often an abuse. It is a simple but inappropriate response to a reality which in the end cannot be avoided, i.e. the comparative advantage of the country whose exports we are attempting to restrict.

The case of textiles provides a good example. The gradual elimination of protection under the Multifibre Agreement came into operation in 1995, with a transition period of ten years. The conflict resulting from the arrival of cheaper Chinese products starting after the elimination of quotas on 1 July 2005 has soured trade relations, e.g. between the EU and China.

The application of safeguard clauses gives rise to the legitimate complaint on the part of exports of the country whose products are affected. They consider that their rights are being illegitimately affected by the abuse of the regulations included in GATT-WTO. This situation is bound to generate trade conflicts.

Unfortunately, this is not all. The safeguard clause is also a perverse mechanism which leads to copycat actions on the part of other countries.

Advanced countries have other means to grant temporary remedy to such difficult situations, especially where the Welfare State is as well established as it is in the North Atlantic area.

Defending industry against private competition harms the country as a whole. Rather than stop the ultimately beneficial effect of international trade,

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[16] International Trade Centre (2004), pp. 4-5.

it would be better to grant income complements to workers directly harmed and for a short time offer incentives for job-seeking. Companies and shareholders should take it on the chin, since entrepreneurship and profit-seeking implies risk.

Anti-dumping policies

A clearer form of protection against foreign competition is accusing a foreign producer of *dumping* excess production in the national market at a lower price that charged in the market of origin[17]. Here a privately owned firm is accused of price discrimination, of charging less than what it charges at home, charging below the "normal value" of the goods or even below their cost. The trade barrier in this case is erected by the home government, by stopping the import or surcharging the goods with a special transitory tariff.

The defence of special interests is here clothed in doubtful economic analysis. Price discrimination has been given a bad name by regulators who do not understand how markets work. The market power of private exporters or of transnational companies may look overwhelming at a given point in time. But this power is always transient, because international finance and technological progress or marketing innovations make entry by rivals possible. Entry of third parties is more likely the greater the profits of the monopolist. The example of the fierce competition and company churn in the automobile industry or air transport industry is enough to convince one that the open market can be penetrated by the most unexpected contestants. Competition corrects discriminatory pricing pretty soon if it is allowed to function.

Let us say we are dealing with steel imports from China and India into the US. The harmed American steel producers could answer in kind and sell the excess produce it cannot sell at home at "dumped prices" in China or India. Prices could soon be unprofitable in both places and dumping could be sustained for only a short period. But if some firms in China or India did have a comparative advantage in steel, that would be an indication the US as a whole would be better off if some of its steel works shut down and the region specialized in industries with a higher relative productivity. If it was shown that

[17] International Trade Centre (2004), pp. 2-3.

Chinese and Indian trade barriers impeded tit-for-tat action by American steel producers that would then be a solid case for retort.

It is true that the low price of foreign imports would harm a minority of the US population. Thus, the owners of fixed factors of production, such as industrial sites or steel furnaces, would sustain a permanent loss, with a depressing effect on the country, and workers who in principle are flexible in the mid-term would have to find new jobs and perhaps would at least temporarily have to take a cut in their earnings, with a further depressing effect on the local economy. But the gain for consumers and downstream users of steel should be taken into account too, and specializing in more productive activities would have a positive effect on national income and spread prosperity across the nation.

Assuming that predatory practices are little more that theoretical cases, dumping is thus an empty concept and is another name for unwelcome competition. It would help relations across the Atlantic immensely if anti-dumping were expunged from the trade vocabulary of the US and EU.

The US has created a perverse combination of public subsidy and anti-dumping with the *Byrd Amendment*, which requires US customs authorities to distribute the proceeds of anti-dumping and anti-subsidy duties to the companies that initiated the procedures. These practices have been denounced by the EU and Canada before the WTO, which has declared them illegal.

Although President Bush has proposed to repeal the law, a repeal by Congress seems unlikely. Meanwhile, both complainants have slapped 15% countervailing duties on selected American exports, and Japan is considering a similar measure. Clearly the US system of government makes thorough reform in commercial matters very hard to effect when legislative changes are needed[18].

[18] Mariko Sachanta, "Japan weighs anti-US duties", *Financial Times,* 29 July 2005, pp. 10.

Public subsidies

Unfair competitive advantages or benefits granted by a government or government agencies to exporters are among the most harmful non-traditional obstacles to free trade[19]. Obviously, this applies to the transatlantic market.

One reason for their negative effect is that they can be prolonged indefinitely, given the taxing powers of countries and the fact that State agencies can often ignore the bottom-line of their profit and loss account. Another reason is that they are justified for nebulous political reasons or on faulty economic grounds. Thus these subsidies can last for ever, reduce the general welfare, and give rise to political conflict among nations.

The most notorious example of the harm caused by subsidies between the partners of the transatlantic area and among developing nations is the practice of subsidizing agricultural exports. The subsidy in the EU takes the blatant form of paying the difference between the artificially high domestic price and the world price – and this world price is actually lower that it might be without EU intervention. The US subsidy is less visible in that it is granted internally so as to lower prices, but it still makes American exports unfairly cheap on the international market. The attempts by both blocks to correct some of the effects of these subsidies by granting privileged access to the poorest nations in their area of influence, as with the Lomé Convention or the Cotonou Agreement, simply adds further pieces to the complicated jigsaw puzzle of bilateral trade agreements. It also lays traps on the way to freeing trade in the current WTO Round since the poorest nations could be harmed by losing their privileged access to the US or EU.

There are other examples of subsidies spilling over into politics. The dispute between EADS/Airbus and Boeing about government subsidies for new models, or about defence procurement guarantees and local tax benefits has become so poisoned that the WTO has been called in to adjudicate.

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[19] International Trade Centre (2004), "Business Guide to Trade Remedies in the European Community. Anti-dumping, anti-subsidy and safeguards legislation, practices and procedures". UNCTAD/WTO, Geneva, pp. 3-4.

The economic analysis underpinning these subsidies is flawed. Two ideas are bandied about as a justification: one is the *infant industry argument*; the other the *mature industry argument*. The two are contradictory.

Despite what the first argument suggests, there is in fact enough capital in the financial markets to finance any sound project. Losses seem not to deter financiers from entering new projects. EADS could very well have found enough capital without having the French Government put up easy loans for the development costs of new models. Similarly, Boeing need not receive special treatment from state governments or the Federal government (if it is the case that it does), or at least the authorities should ensure that those benefits are open to all companies of any nationality, and under the same conditions.

The other argument is the exact opposite. It suggests that an industry in mature markets cannot withstand the competition of producers from developing regions, where labour costs are lower. But low labour costs cannot last indefinitely, since wages (divided into their two elements, private and social) are connected with productivity and rise as countries become more prosperous. Japan or South Korea, for example, are no longer accused of social dumping by American organized labour. So-called unfair competition from developing countries in simple products, such as simple textiles, is a sign that advanced countries would be better advised to move up the value chain and specialize in the production of goods and services in which they have a relative advantage.

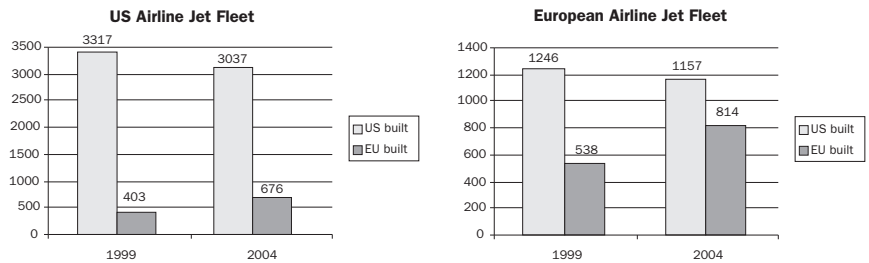
Still, there may be situations where foreign subsidization of exporters will have to be borne, taking account of the possible advantages to consumers or users of the subsidized import.

THE AIRBUS-BOEING CONFLICT. PUBLIC SUBSIDIES AND POLITICAL PRESSURE

In the aircraft industry, Europeans traditionally lacked the strength to compete globally with the major American companies which, for historical reasons, had led the market from the start. This situation changed in the 1980s with the combined efforts of European countries to develop what was considered an industry in its infancy and in need of protection. With the development of the European consortium EADS-Airbus, American producers also started on a merger path towards greater efficiency. This has led to a situation of a technical duopoly in a big part of the world market for commercial jets[20].

Competition has accelerated technological progress and both the US and Europe are the undisputed world leaders in a large section of the world aerospace market. Both Airbus and Boeing have acquired complementary roles in many aircraft markets and have enhanced benefits for customers around the world. An important part of their business is in the form of defence equipment, where the US enjoys a supremacy due to its greater investment in research and development.

Figure 4.4. European and US Airline Jet Fleet



Source: Teal Group Corporation

With the rise of the European industry it became necessary to draw up a set of rules for the manufacturers to ensure fair play. The Agreement on

[20] Cfr. Richard Aboulafia (2005), "*Commercial Aerospace and the Transatlantic Economy",* in Hamilton and Quinlan (2005), op. cit.

Trade in Civil Aircraft (ATCA) was approved in 1994, as a component of the WTO agreements. The ATCA did not remove the barriers to the purchase of foreign aerospace equipment but it codified the existing problems and extended precedent to new signatory nations. For the jetliner trade, the ATCA meant a compromise for the elimination of:

1. Tariffs on imported aircraft, engines and parts;
2. Quantitative import restrictions such as quotas;
3. Government influence over aircraft purchase decisions through incentives or unacceptable pressure on purchasers;
4. Removal of mandatory sub-contracts in the aviation industry associated with aircraft sales.

ATCA was a framework in which civil aviation manufacturers from the EU and US, as well as from other countries, could compete on the same playing field. It added extra impetus to the race for increasing market share.

Despite the ATCA, there is still one important barrier in the aircraft industry to be removed: public subsidies.

Europe's Airbus has received generous aid from every government represented in the consortium as well as from those where important contractors are based. When Airbus started, it was argued (not very convincingly) that without the initial financial support aid at the European or national level, it would be impossible to undertake the capital-intensive projects involved in the development of aircraft.

Whatever the initial case may be, are those subsidies still necessary today when Airbus has been able to beat arch-rival Boeing in many bids in the last two years? Certainly not.

The case of Boeing is much the same. Its position as a developer of aircraft for the US Armed Forces and its participation in projects for NASA have meant millions of dollars in subsidies that have also been used in its civil aviation branch.

Furthermore, both companies have increased their presence outside their home countries: Boeing has established a research centre in Russia, and

Japanese manufacturers represent as much as 30% of its newest model B787. In these countries, as well in others like Mexico, the company has benefited from public funding. Airbus, thorough its parent company EADS, has broadened its original borders to Eastern Europe and has continuously received public aid.

Mutual accusations of market distortion through public subsidies to both Airbus and Boeing have led to an important headline-making trade conflict between the EU and the US. The conflict is now being reviewed by the WTO.

As if this were this not enough, not all the airlines (the customers of Boeing and Airbus) are privately owned, and even those which have private shareholders are not free from tight regulation from government authorities. This means that the final customers of aircraft manufacturers are exposed to the influence of politics.

For both the US and Europe, each purchase of an aircraft means job creation, working hours, recuperation of research expenses, and an increase in worldwide reputation. If we add the fact that both companies receive subsidies and financial aid from their own governments, it is clear that political interests become critical in their decision-making process.

Buyer companies are thus subject to pressures from local governments acting on the request of US or EU governments. Japan's publicly-listed All Nippon Airways (ANA) chose Boeing to renew its jet fleet despite the fact that the Airbus offer was significantly more attractive. The same thing happened in India and Taiwan[21]. Both the US and the EU use these deals as instruments in their bilateral trade relations with countries such as Japan, China or Taiwan, with which they both have significant trade deficits. Moreover, the buyer countries also use these bids as a foreign policy tool to punish or reward certain political attitudes or decisions.

Decisions by anti-trust bodies

Despite some substantial differences in the objectives of competition policy, the EU and US have made significant efforts to increase cooperation

[21] See *The Wall Street Journal*, "US Lawmakers Push Taiwan to Cancel Airbus Deal, Hire Boeing", September 12, 2002

between their competition agencies. This is resulting in the development of complex, but increasingly convergent, systems.

However, Europeans and Americans still often use different economic and legal instruments and procedures to address the same situations. This often leads to divergent conclusions, and ultimately to a disintegration of the transatlantic market.

The main difficulty in cooperation appears to be the coordination of the legitimate interests of each jurisdiction in terms of competition with the interests of companies and consumers, and to ensure that competition policy is not used as a tool for industrial policy, or even a behind-the-border form of protection.

There are three basic risks when a case related to competition affects more than one jurisdiction[22]:

i. The cost, complexity and uncertainty of having to comply with various regimes, demands for information, and programmes, which eliminate the positive effect of some of the broad-ranging agreements capable of increasing the system's efficiency, and which result in disadvantages for consumers.

ii. Different analyses may lead to different results. There is no objection to the existence of different results when the relevant facts are different in different jurisdictions (regional and national markets). More worrying is that the differences may arise because of different legal standards or analytical processes which are significantly different;

iii. The economic nationalism of some regions when applying their competition instruments, coupled with the politicization of their application.

For this reason it is important to maintain the principle that in cases of multiple jurisdictions, the decision determining whether a company's action is

[22] Charles A. James, "*Antitrust in the early 21st century: core values and convergence*", 15 May 2002. http://www.usdoj.gov/atr/public/speeches/11148.pdf

contrary to competition or not should be as rigorous as possible when challenging the legitimacy of the action.

These risks have to a certain extent been mitigated. The *1991 Agreement on the application of competition laws* includes [23]:

- *Mutual notification of cases* investigated by the competition authorities of one party which may affect the important interests of the other party (Article II), as well as the exchange of information on general aspects relating to the implementation of competition rules (Article III);
- *Cooperation and coordination of the actions* of both parties' competition authorities (Article IV);
- A *traditional comity* procedure by virtue of which each party undertakes to take into account the important interests of the other party when it takes measures to enforce its competition rules (Article VI);
- A *positive comity* procedure by virtue of which either party can invite the other to take, on the basis of the latter's legislation, appropriate measures regarding anti-competitive behaviour implemented on its territory and which affects the important interests of the requesting party (Article V).

The 1991 Agreement also makes clear that none of its provisions may be interpreted in a manner which is inconsistent with the legislation in force in the European Union and the United States of America (Article IX). In particular, the competition authorities remain bound by their internal rules regarding the protection of the confidentiality of information gathered by them during their respective investigations (Article VIII).

In 1998, the means of applying the positive comity procedure and the circumstances in which could be called into effect were specified. In particular, the conditions were laid down in which the requesting party should normally suspend its own enforcement measures in favour of the enforcement measures adopted by the requested party. Thus positive comity allows competition

[23] Agreement of 23 September 1991 between the European Communitites and the Government of the United States of America regarding the application of their competition laws [DOL 95 of 27.4.95 pp. 47-50].

problems to be resolved by the body in the best conditions to do so, in particular by carrying out investigations or imposing sanctions, as may be the case[24].

However, despite the cooperation and convergence achieved, there are some cases which have highlighted certain differences and which show the need to promote a greater convergence between the two governments. Among the best-known cases are the merger of *Boeing and McDonnell-Douglas*, and the later case of *GE/Honeywell* (the first European veto of a merger authorized in the US). Recently there have been wide-ranging differences in a case involving unilateral action, and which has been widely reported: *Microsoft*.

THE GE/HONEYWELL CASE

The debate on the GE/Honeywell case has certainly made an important contribution to convergence in terms of the revision of the idea of concentration. It has demonstrated a simple but fundamental divergence in philosophy on economic aims and the extent of application of competition rules.

The case referred to the effect produced by the merger between GE, a manufacturer of engines for large aircraft, and Honeywell, a manufacturer of engines for smaller business aircraft and flight systems. The two belonged to different markets, and the main effect on competition would be the creation of synergies derived from the combination of financial resources and/or possible barriers to entry[25].

According to the American philosophy, this kind of merger could have desirable long-term effects in terms of efficiency, since the resultant company could take advantage of synergies and lower prices, sometimes

[24] Agreement of 29 May, 1998, between the European Communitites and the Government of the United States of America relating to the observance of the principles of positive comity in applying their competition laws [DOL 173 of 18.06.98 pp 26-27]. In March 1999, the EU agreed with the US the administrative subjects related to the application of the agreement (the "Administrative Arrangement on Attendance) and in June a similar agreement was entered into with Canada.

[25] Cf. Mercedes García Pérez, "*Test de dominancia vs. Test de disminución sustancial de la competencia: a debate el criterio para prohibir una concentración"*. Centro de Política de la Competencia, II Seminario de Expertos, Universidad San Pablo CEU.

offering its products through linked sales. This behaviour is considered beneficial for competition, since consumers receive products at a reduced price, or have access to better services resulting from the combined offer of the merged companies[26]. However, an analysis of this kind of operation by the European Commission showed a divergent point of view, since the European Union carried out an *ex ante* analysis and banned the merger because of its possible consequences.

The merger was authorized in the United States because the Department of Justice considered that the resulting company could offer better products and prices for consumers. The European Commission, however, argued that the merger would reinforce the dominant position of GE in the market for large jet engines, because the companies offered linked sales. The result would be that some competitors would have to abandon the market. The analysis of the competitive position of the other companies in the market is thus one of the most notable differences between the position of the Department of Justice and that of the Commission. First, the Department of Justice did not find any proof that the GE competitors would not be able to react in the face of a possible anti-competitive behaviour by GE. Secondly, the American analysts agreed in pointing out that the exit from the market of a competitor as a result of a merger is not necessarily anti-competitive, if the consumers are not harmed[27]. Although Commission representatives have tried to answer the accusation of those who think that their policy of controlling mergers protects competitors rather than consumers[28], the truth is that the Commission never argued that the merger would in the short-term lead the parties to increase prices and thus harm consumers.

The key to the disagreement between the Commission and the Department of Justice in the GE-Honeywell case is thus in the perspective adopted in each case: the Department of Justice and the Federal Trade Commission consider

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[26] Cf. William Kolasky (2001), "*Conglomerate mergers and range effects: It's a long way from Chicago to Brussels*", 9 November, George Mason University Symposium, Washington, DC. http://www.usdoj.gov/atr/public/speeches/9536.htm

[27] Cfr. Charles A. James (vid. supra).

[28] Mario Monti, 9 July 2001, SPEECH/01/340.

that the most effective form of answering the kind of problems which may arise from a conglomerate merger (illegal linked sales or predatory pricing) is through sanctions once such effects occur, unless at the time of the merger it can be demonstrated that such anti-competitive behaviour will clearly take place[29]. By contrast, the Commission considers that the fact that a merger makes such behaviour easier is sufficient reason to ban it, i.e. it adopts an *ex ante* attitude.

These different perspectives are used to analyse all kinds of mergers. Thus the US blockade on horizontal mergers is related to the greater possibility of the merged company eliminating a competitor, and thus being able to restrict production and increase prices. Similarly, vertical mergers are challenged if they eliminate a key supplier or customer, giving the merged company the capacity and incentive to increase its rivals' costs, thus once more provoking a restriction in production or an increase in prices. The European Union policy, on the other hand (especially towards conglomerates, as exemplified by the GE/Honeywell case) is based on prohibition as a mechanism for preventing the merged firm from acquiring a position of dominance and becoming a stronger competitor, capable of expelling its rivals from the market.[30]

From the above, it may be inferred that the benefits of a greater convergence are particularly clear when assessing the consequences of specific behaviour by each of the different jurisdictions involved. The cause of the problem is the coexistence of different decision-making factors. In particular, that creating or reinforcing a position of dominance, which has been adopted in Community law from the start[31], and that of a potential

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[29] Cfr. W. Kolasky, vid. *supra.*

[30] Cfr. Charles James (vid. supra) the anti-monopoly legislation to protect competition not competitors. William Kolasky (vid. supra) takes the same view. The competition agencies in the US should rarely interfere with mergers.

[31] Article 82 of the Treaty constituting the European Community. "Abusive exploitation by one or more companies… of a position of dominance in the common market or a substantial part of it… will be incompatible". Article 2(3) of Council Regulation (EEC) No 4064/89 of 21 December, 1989, on the control of concentrations between undertakings, Official Journal L 395, 30.12.1989, pages 1-12, amended by Council Regulation (EEC) No 1310/97 of 30 June 1997, Official Journal L 180, 09.07.1997, pages 1-6, declares the following as incompatible with the common market: "concentrations which represent an obstacle for effective competition by creating or strengthening a dominant position in the common market or in a substancial part of it."

significant reduction in competition, which is applied by the United States. For this reason, there have been calls to change the test used to analyse the effects on competition of the concentrations which are the object of Community jurisdiction, based on the concept of position of dominance, and use instead the idea of the considerable reduction in competition[32].

The reason is that in practice, the position of dominance can be achieved without the need for a merger or acquisition. Unilateral behaviour by a company can also take it to a position of dominance. Unilateral operations are understood to be those leading to a situation of monopoly, in the American terminology, or the position of individual dominance, in European terminology, without the need for mergers or acquisitions among the competing companies. The negative effects which may arise from these kinds of operations lie in the fact that they can lead to increases in prices or restrictions in supply.

In terms of the relations between the competition policies of the United States and the European Union, the case of unilateral action by a company is also an example of very significant divergence. A good example of this is the recent *Microsoft* case before the European Commission[33]. The thresholds established in Europe for deciding whether a firm is in a position of dominance appear to be lower than those generally accepted in the United States for the same purpose.

It is clear that the objective of a policy defending competition is to ensure that companies compete by lowering prices, innovating and making products more attractive. The main problem in terms of unilateral conduct is that it is extremely difficult to differentiate between aggressive competition and anti-competitive conduct. The focus of the analysis is the position of dominance, and it is not easy to use arguments based on efficiency, which is how most

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[32] Despite the conceptual differences which these terms may include, from the economic point of view they seem to refer to the same point: monopoly.

[33] Ten representatives of the International Relations Committee of the US Congress (5 Democrats and 5 Republicans) sent an open letter to Commissioner Monti opposing the decision taken by the Commission in the Microsoft case. They stated that the decision violated the spirit of the 1991/98 agreement on competition (CNET News.com, 24.03.2004).

experts today believe that the policy should act. It is true that if a company has a position of dominance, it can act independently of its competitors and customers, so that it will not transfer the potential benefits of operation to consumers.

However, there are clear differences between the two approaches, as expressly stated by former Commissioner Monti himself[34]. In his opinion, the competition authorities should consider intervening when a dominant company may use its power to gain a market share for reasons which are not related to the price or quality of its products. Without such intervention there would be a real risk that competition could not play its role, to the detriment of consumers and innovation. This does not stop Monti from being aware that it may be very difficult to distinguish real competition from a strategy of predatory pricing, for example, in the case of a company with a position of dominance in the market. However, he believes that this should not stop the competition authorities from carrying out an in-depth analysis on whether the anti-competitive effect of unilateral action has a greater weight than the potential benefit resulting from greater efficiency, bearing in mind the good of the consumer.

There is no doubt that the differences in applying the rules do not contradict the fact that the main objective is efficiency and not the existence of a greater number of agents in a given market. Competition is thus valued not as an aim in itself, but because it promotes the efficiency of the economic system.

The Federal Trade Commission of the United States has pointed out that the differences with the European Union also refer to procedures and evidence presented. Among other factors which could be mentioned in the case of cases studied by the US authorities is the greater time and resources used, the role played by economists in investigating the case in question and in taking decisions, as well as the greater emphasis placed on quantitative

[34] Comments by Mario Monti replying to the speech by Hew Pate, Assistant Attorney General, US Department of Justice, at the conference "Antitrust in a Transatlantic context", Brussels, 7 June 2004.

analysis. In other words, criticisms of European policy in this respect are not only of the lack of a role for professional economists in the procedures, but also of their organization.

Finally, in terms of the prosecution of cartels, restrictions for reasons of confidentiality have restricted joint efforts to work in this field, so that cooperation at a similar level to that achieved in the case of concentrations has not been achieved. Despite this, cooperation in investigating cartels is almost routine, and numerous surprise inspections are carried out during the procedures. It is also a case of trying to create a climate that dissuades future cartels from being formed.

To sum up, it must be admitted that despite existing problems, the European Commission has worked in close collaboration with the competition service of the US Department of Justice and the Federal Trade Commission. This collaboration has resulted year after year in a variety of reports presented by the competition authorities.

It should also be pointed out that there has been greater cooperation to reinforce the fight against agreements between international companies and a greater convergence of points of view between the authorities on both sides of the Atlantic on the establishment and application of corrective measures and later monitoring designed to check the implementation of agreed measures.

In this, regular high-level meetings and contacts have been of great benefit. Such cooperation is extremely useful for both sides, since it leads to an improvement in the measures applied, and helps to avoid useless legal battles and incoherencies between the measures taken. It also improves the understanding of each other's competition policy. We may conclude that there have not been as many divergences as may appear at first sight, although those that have existed have at times received great publicity, as in the case of Microsoft.

Decisions by regulatory bodies

The continuous progress in cooperation between the European Union and the United States on the question of regulation is extremely important for their

economic relations and is essential to preserve and increase the benefits from the transatlantic market by avoiding possible friction between the two systems, which could adversely affect its development. There has been significant progress on the question of reconciling regulatory approaches on both sides of the Atlantic. The recent creation of a High-Level Group to deal with regulatory cooperation is good news. .

However, the truth is that great efforts still have to be made to achieve greater opening-up, flexibility and progress on controversial questions. The aim of a cooperative approach on regulation is to prevent a duplication of controls and to avoid the incompatibility of regulations. If the regulatory systems had a greater level of coherence, both economies would benefit, since trade would be made easier. It would also limit the number of cases when necessary protection in sensitive areas such as health, the environment and public safety may be used as a barrier to free trade and foreign investment.

The European Union and the United States pursue different paths on regulatory questions, so convergence may be difficult. Negotiations in this field are bound to be complex, and generally affect numerous agencies on both sides of the Atlantic. Each has its own responsibilities and mandates, and to complicate matters still further, the approach and implementation of each regulatory model reflects differences in terms of government structure and administrative tradition. Thus in general the European Union pursues a more prescriptive approach, by which the regulators inform the industry how they should conform to the regulations. In addition, the regulatory bodies tend to base their rules on the *precautionary principle*, which critics in America consider does not sufficiently take into account relevant scientific data and can lead to over-zealousness in the prevention of risks.

The 1992 Rio Declaration[35] defines the precautionary principle as follows: “Where there are threats of serious or irreversible damage, lack of full

[35] Adopted by the governments participating in the UN Environment and Development summit which took place in Rio de Janeiro, Brazil in June 1992. Despite its explicit reference to environmental protection, in practice the application of this principle is much wider and also extends to consumer policy and human, animal and plant health.

scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation" The main problem posed by the precautionary principle is that it does not bear in mind the costs of not doing something. As a result, public opinion only sees advantages in it, and is not aware of the possible damage caused by excessive precautionary measures. In addition, this principle has also been related to an objective that is not strictly linked to environmental protection or health, but to the imposition of protectionist barriers to trade, restrictions on the use of private property, and the increase in State power in the life of individuals.

Unlike Europe, the United States bases its regulatory model on a legislative approach which is more geared towards results. Regulators specify certain requirements, and leave industry free to achieve them in the way they best think fit. Decisions have to be taken on more scientific grounds, as the product of rigorous risk analysis. In addition, the processes of legislative revision on both sides of the Atlantic are different. In the European Union, decisions by regulatory agencies need political support more often, because they are considered institutions created to carry out a technical, scientific or other specific tasks. By contrast, the US model gives greater independence to regulatory agencies and encourages public participation in the process. There is no doubt that the differences at all regulatory levels can create friction between the parties, and an insufficient level of cooperation leads to direct costs to companies and consumers. It must also be pointed out that in general regulators act thinking about their own market and their own companies, and often do not bear in mind the impact which the laws they propose may have on foreign companies.

REGULATION ON CONSUMER PROTECTION

Regulation on consumer protection is all too often a source of trade squabbles between the US and the EU. We think there is one simple reason behind this friction over trade: concealed protectionism promoted by powerful lobbies.

Genetically modified organisms (GMO) and hormones (hormone-treated beef) are just two examples of issues related to consumer protection that have generated important transatlantic conflicts.

More recently, the EU REACH Directive has resulted in a new and serious conflict with regard to chemicals[36].

Pharmaceuticals are another classic area of trade squabbles[37]. Removing the transatlantic barriers would be of great help for the pharmaceutical industry[38]. The fragmented European market and different regulations across Europe (safety rules and reimbursement policies affecting the pricing of drugs) are the other two main barriers[39]. Disputes between the US Food and Drug Administration (FDA) and the EU DG Enterprise/Pharmaceuticals Unit and/or the European Agency for the Evaluation of Medicinal Products (EMEA) on matters related to the safety, quality, and efficacy of pharmaceutical products are very frequent.

Though not so much in the public eye, trade conflicts between the US and the EU resulting from regulation on consumer protection have taken place in many other sectors as well. These are just a few:

— Organic food products

— Wine: Disputes dealing with oenological practice.

— Poultry trade

— Auto safety: Conflicts between the US National Highway Traffic Safety Administration (NHTSA) and DG Enterprise/Automobile Unit regarding auto safety regulations.

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[36] Cfr. Jacques Pelkmans (2005), *"REACH: Getting the Chemistry Right in Europe"*, in Hamilton and Quinlan, op. cit.

[37] The key element in the industry is the need to recover the enormous R&D costs of developing a drug on a worldwide market basis. Estimated costs of a drug from molecule to market vary from $802 million to $1 billion (Tufts Center for the study of drug development, Tufts University) and therefore a market without barriers would be a significant step towards promoting further research. Cfr. Françoise Simon (2005), "*The Transatlantic Outlook for the Biopharmaceutical Sector"*, in Hamilton and Quinlan, op. cit.

[38] The American market is much bigger (46% of world sales by value) and it has a relatively free pricing system with a mostly transparent regulation that includes legal restrictions on the use of stem cells and other bioethical issues.

[39] Different pricing schemes lead to "parallel trade" within the EU.

— Cosmetics: Conflicts between the US Food and Drug Administration (FDA) and DG Enterprise/Cosmetics Unit regarding non-animal testing methods, respective regulatory approaches applied in the area of hair dyes and some other areas.

As an example, the arguments used in the trade conflict between the United States and the European Union on the regulation of *genetically modified organisms (GMOs)* are particularly illustrative.

The United States is the world leader in the production of genetically-modified agricultural raw materials, and the main obstacle for their expansion is in the European Union, where the regulations and authorization procedures required for their cultivation and trade are different from the American ones.

The differences on both sides of the Atlantic are far-reaching, and deal with both scientific and ethical questions. The present regulations reveal a different political assessment of the effects of GMOs on health and the environment, and of the techniques employed. American critics stress the existence of a particular political position in Europe which is less a reflection of scientific opinion than of the opinion of the general public and/or pressure groups which see a source of threat in this technology.

Representatives of industry and the US Administration have expressed their discontent with the delay and cost which companies have to undergo to obtain the authorizations needed in the EU market. They consider this a technical barrier to trade and contrary to the WTO rules, and in their opinion has a negative effect on exports. This criticism became tougher as a result of the labelling and traceability requirements imposed by the European Union.

One of the aspects that should be highlighted on the legal question of biotechnological agriculture is that it implies an assumption of risks whose magnitude is unknown and which has a transcendent effect on goods and rights which are the subject of law, such as biodiversity and the consumer health. The United States and the European Union have

adopted different regulatory positions in relation to the prevention of these risks.

In 1992, the United States considered that as a general rule transgenic food did not need a special regulation, and that it was sufficient to apply general laws for the sale of such products[40]. Thus the US Administration authorizes all transgenic products except those which have been demonstrated to be harmful to health and the environment.

The EU, by contrast, uses its interpretation of the precautionary principle and regulates transgenic food in a more restrictive way, requiring approval from committees of national and EU experts[41]. The specific legislation for these products considers both their use as food and the techniques used in producing them. The European Union regulations are based on considering that from the very fact of their novelty, GMOs generate scientific uncertainty, and thus represent a potential danger which could appear in the future. This is the justification for using the precautionary principle to impose an exhaustive preliminary assessment of environmental and health risks. Thus the European model establishes a number of stages that the products have to pass before they can be marketed. Companies which want to market a GMO for the first time have to include a complete analysis of the risks that the product could represent for the environment. If the national authority emits a favourable judgment, it will tell the other member states through the Commission, and if there are no objections, the transgenic product can be placed on the domestic market.

In May 2003 the United States lodged a complaint before the WTO against the moratorium that had been imposed practically since 1999 by the European Union as a result of a revision of its Directive, resulting in a de facto

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[40] The federal agencies involved in the approval of GMOs are the APHIS (Animal and Plant Health Inspection Service), the EPA (the Environmental Protection Agency) and the FDA (Food and Drug Administration).

[41] The Community agencies involved are EFSA (European Food Safety Authority) and CPVO (Community Plant Variety Office) whose work here consists in supplying technical reports for drawing up the corresponding Directive.

suspension of new authorizations, above all on food[42]. The US considered this suspension to be in practice an embargo[43].

To sum up, the European Union has invoked the precautionary principle to ban the import of GMOs using the argument that it was protecting the health of consumers and the environment. Despite the fact that no study has demonstrated any negative effect of GMOs, the argument is based on the fact that this type of food is not 100% safe. The precautionary principle has become an obscure and excessively simplistic concept which gives the State the discretionary power to decide what is good and what is bad for individuals. It holds back the development of science and technology, and restrains economic growth by creating difficulties for what is one of its main driving forces, i.e. innovation.

Public procurement

As part of the programme creating the European Common Market, the member states of the European Community agreed to deregulate their national public procurement markets. In theory, European firms could in this way have access to public contracts without any discrimination[44].

Specifically, in 1990 the Directive on utilities opened public procurement to competition in sectors which were excluded until that time, in particular, water, energy, transport and telecommunications. After a wide-ranging debate, the Council agreed to include a *reciprocity clause*, whose aim was to allow the control of the effects of domestic liberalization measures. Thus two discriminatory regulations were introduced to prevent the free-rider effect.

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[42] WTO. DS291: European Communities – Measures which affect the approval and marketing of biotech products (complaint by the United States): 20 May 2003. In November 2004 the panel estimated that it would have a final report ready by June 2005.

[43] Following the US petition, the WTO has already condemned the European Union for banning the use of certain growth hormones without scientific analysis of their inherent risks in meat consumption. The sanctions were established in July 1999 and consisted of an increase in the customs rights on a range of products.

[44] In the same way, public and semi-public institutions could acquire goods and services of greater quality and at a better price, thus contributing to economic development and stimulating competition.

Under the first of these, European producers had a 3% preferential price treatment in the award of public contracts; under the second, the contracting bodies could exclude tenders in which less than 50% of the goods or services offered are of Community origin.

These preferential criteria were to be applied to countries which did not offer the same degree of opening-up as the European Union in terms of the process of public procurement in a particular sector. Thus in terms of bilateral relations, this could become an instrument for negotiation with the United States on the non-application to European companies of discriminatory US legislation, mainly the *Buy American Act* of 1933[45]. In other words, there could be an offer to withdraw the reciprocity clause once an international agreement on the question was reached.

In April 1993 the European Union reached a partial agreement with the United States under which the reciprocity clause would not be applied in certain cases, mainly in the electronic equipment sector. In exchange, the United States eliminated discriminatory laws affecting European tenders for federal electricity procurement offers. The United States also began a process to eliminate the buy-American clauses at a sub-federal level. However, this agreement was only partial, since most of the public sectors in Europe maintained the reciprocity clause, above all the case of telecommunications. The result was that the US applied sanctions to the EU[46], to which the European Community replied with the application of its own measures[47].

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[45] The Act gives a preferential price treatment of 6%-12% for products of American origin in all purchases by federal agencies. It also requires a "made in the USA" content of 50%. It is initially applied to goods, although it has inspired similar clauses for services. It allows the purchase of foreign products only in certain circumstances, for example when the purchase of an American product is not in the public interest.

[46] Title VII Trade Act of 1974 amended by the Omnibus Trade and Competitiveness Agreements Act of 1988. It designated the EU as a country which maintains discriminatory practices against the US and applied economic sanctions (except in the electrical sector) worth about $20 million a year. They have been maintained until today because of a lack of agreement in the telecommunications sector.

[47] Regulation 1461/93. In response the European Union also applied economic sanctions worth about $15 million.

In April 1994, with the conclusion of the Uruguay Round, the European Union signed a new agreement in the framework of the WTO to open up the market of public procurement to real competition, the *Government Procurement Agreement* (GPA)[48]. The new agreement came into force in 1996.

The GPA is more ambitious than the previous GATT agreement of 1979 in terms of details and areas covered, since it includes goods, services and public works, and is not limited only to supply of the central State administrations, but also public purchases at a sub-federal level and other non-State bodies[49]. It is important to highlight that this agreement does not cover all the practices and areas of public procurement. There are some reciprocal exceptions between countries which have signed it, violating the spirit, if not the letter, of the agreement.

Throughout the last twenty years the European Union has published annual reports on trade barriers and European investment in the United States, with the aim of identifying the problems related to access and the functioning of the market. Among the most important of the numerous barriers identified are those related to public procurement.

The 2004 report highlights various concerns[50]. Many of them have continued over many years. For example, the wide ranging *buy-American* clauses can adopt various forms: some of them prohibit public bodies from acquiring goods and services of foreign origin; others lay down requirements as to the local content of purchases; finally, others guarantee price preferences for local suppliers. These restrictions do not only reduce opportunities for European exporters to enter the US market. They also dissuade American bodies from using European services in their procurement.

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[48] It is based on the general principles of national treatment, non-discrimination and transparency of procedures, and provides a system of thresholds linked to obligations and a mechanism for conflict resolution by the aggreived parties. The United States are also signatories to this agreement. As a result, a large proportion of the previously acquired commitments have been integrated into it.

[49] In the case of the United States, for example, 37 of the 50 states have agreed to enter into the GPA, with their administrations entering into letters of commitment with the Federal Administration.

[50] EU"s 2004 Report on United States Barriers to Trade and Investment.

In this way local producers, whether through the ordinary justice system or by lobbying, ensure that the buy-American preferences are maintained and reinforced.

As a result of the GPA the parties have introduced various restrictions to discriminatory clauses[51]. However, in practice the application of these restrictions by the US produces uncertainty in some cases, which can in itself act as a barrier. The clauses that remain continue to limit access to the American market in a significant way. The European Commission estimates that the sectors most affected are public transport and airport reforms, sectors in which the European Union is very competitive.

One of the clearest examples of discriminatory practices of the buy-American kind invokes the concept of national security, and is based on the *Defence Appropriation Act* of 1941 (known as the *Berry Amendment*). It is used by the Defence Department, the biggest source of public procurement in the United States[52]. These practices are justified with the argument that national security cannot be compromised by revealing the needs of an agency to persons who do not have access to classified information. However, its scope has been extended to the protection of security for a wide range of products that are only tangentially related with national security interests, such as textile products. Despite the fact that the concept of national security can be invoked under Article XXIII of the GPA to limit procurement from foreign suppliers to the defence sector[53], the use of these justifications by the United States has in practice led to a disproportional reduction in the range of offers by the Department of Defence covered by the GPA.

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[51] For example, the application of buy-American practices can be suspended by Presidential decision in the case of countries which form part of the GPA or which provide adequate opportunities for American producers and suppliers to access the local market. For other countries, the buy-American laws remain intact.

[52] Other sources of this restriction are: the National Security Act of 1947 and the Defence Production Act of 1950. The Executive Order 10582 of 1954 permits the rejection of foreign bids for reasons of "national interest" or "national security".

[53] This article allows any of the parties to use the concept of national security to refuse foreign tenders. The GPA does not contain clear standards on the type of cases to which national security exceptions can be applied.

The buy-American legislation is also very common at a sub-federal level, as in America more than half of the states apply restrictions of the buy-local kind in one form or another.

In terms of sub-federal practices, it is worth remembering the case of the conflict between the United States and the European Union which arose in relation to procurement by the State of Massachusetts in 1998. It reflected the combination of two of the most important problems in this kind of economic relation. First, it was a case of a sub-federal government in America and a possible violation of international obligations. This type of conduct is a constant worry for the European Union and it is reflected by a continuous mention in annual reports on trade barriers in the US. Secondly, the law had an extra-territorial regulatory effect, as it attempted to limit the policies of foreign (and US) companies in Myanmar (Burma). Thus sanctions were imposed on products supplied by companies with financial interests in Myanmar, on the grounds that its illegitimate military government repeatedly violates human rights. In accordance with this law, the government of Massachusetts had to maintain lists of companies which had business in Myanmar and prohibit the state from procuring goods supplied by companies on the list (with certain exceptions when the procurement was essential, as in the case of medicines, or when there was no comparable offer available).

The extra-territorial application of law by the United States is a real problem, and it had created friction with European countries long before the conflict with Myanmar. This kind of friction is particularly clear in the case of economic sanctions for reasons of foreign policy.[54] The proliferation of measures such as the Massachusetts law at a local level was the reason why the European Union, and later Japan, brought the case before the WTO. However, the case never reached the Dispute Settlement Body of the WTO, since the law was considered unconstitutional in the three levels of the US federal circuit (the district federal court, the federal appeal court and the US Supreme Court).

Another kind of restriction, mainly local in character but which is also found at federal level, is the policy of promoting small businesses. Under this

[54] A clear example is the Helms-Burton Act, which penalizes economic relations with Cuba.

system, the public bodies have to make a proportion of their purchases (not less than 20% in a fiscal year) from small companies in the corresponding sector (Small Business Act 1953). It is true that the promotion SMEs is also an important part of EU policy. However, interest in these kinds of businesses in no way justifies the measures adopted (and making an exception of them in the GPA) because they favour American industry and restrict the ability of foreign companies (not only from Europe) to enter the US market.

To sum up, there are many varied measures adopted in the United States at a federal and/or state level restricting suppliers" access to purchases by public and semi-public bodies. In addition to those already mentioned, an example was the award of contracts by the US Agency for International Development (USAID) for reconstruction in Iraq[55]. These kinds of purchases are excluded from the GPA framework, although they are not directly related to cooperation and development. The long list of complaints relating to American policy also includes restrictions on foreign property, in terms of the contribution of activities of a foreign company to the economy and employment in the US or to compliance with specific production parameters (volume, content, etc.).

The United States also publishes annual reports on the barriers which various countries impose on American exports[56]. Among the most important reports are those referring to the European Union. Thus, the National Trade Estimate Report on Foreign Trade Barriers (NTE) of 2004 identifies the provisions of the Utilities Directive mentioned above as the main barrier[57].

Specifically, the criticism focuses on the reciprocity clause and points to special and exclusive rights in the telecommunications markets of certain member states (these were the cause of the sanctions mentioned in 1993). The 2005 report mentions the existence of the new EU Utilities Directive

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[55] These were extremely large contracts for the reconstructing of Iraq and the hen Provisional Coalition Authority. Arguments have been put forward supporting restrictions of competition. They include preserving access of contracts to those who made possible the liberation of the Iraqi people.

[56] National Trade Estimate Report on Foreign Trade Barriers (NTE).

[57] The same barriers are mentioned in the Annual Report on Discrimination in Foreign Government Procurement (commissioned to USTR in 1999, 2000 and 2001).

(Directive 2004/17) whose implementation is planned for January 2006. The report maintains the criticism of the existence of discriminatory clauses for offers with less than 50% of European content when they are not covered by any bilateral or multilateral agreement. This requirement is applied to suppliers of goods and services in the following sectors: water (production, transport and distribution of drinking water); energy (gas and heating); urban transport (buses, urban trains, trams, etc.) and postal services. An important change in the new Directive is that it appears to completely exclude the telecommunications sector, something which has long been called for by the United States.

Court decisions

Both the court rules and the practice of recognizing court decisions differ substantially among the states in America, and among the countries of Europe. The impact of these differences in the resulting legal disputes over transatlantic transactions is extremely significant. Despite the importance of these questions, there is at present no bilateral agreement between the United States and the European Union on jurisdiction, recognition and enforcement of court decisions related to civil and mercantile questions[58].

In the multicultural sphere, the Hague Conference on Private International Law is preparing a project for a worldwide convention related to jurisdiction. The aim is to help the recognition and the execution of decisions in civil and mercantile cases among countries which are parties to the convention[59]. This convention would benefit both natural and legal persons. For example, if a European company was subject to a judgement by a court in a member state for non-compliance with a contract by a foreign partner, it could under this future convention place an embargo on the assets of the losing party in any third state which was signatory to the convention, without having to go to the

[58] The closest collaboration is at present related to legal assistance and extradition in cases linked to the fight against terrorism.

[59] The work began in 1992 on the suggestion of the US delegation to achieve a multilateral convention on jurisdiction, recognition and enforcement of foreign judgements on civil and commercial matters. However, the preliminary 1999 document was rejected by the US delegation on the grounds of significant defects in the approach, structure and details of the text. A definitive text has not yet been agreed on.

courts again and thus face the possibly excessive costs of a further court action.

In Europe there are already instruments of this kind. Jurisdiction, recognition and enforcement of judgements on civil and commercial matters are regulated by the Brussels Convention of 27 September 1968, which is binding on all the EU member states. Its competence has been extended to cover the member states of the European Free Trade Association (EFTA)[60], under the Lugano Convention of 16 September 1988, which contains practically the same provisions. The Brussels Convention was progressively extended to cover the new member states of the European Union, and from 2002 it was replaced by Council Regulation (EC) No. 44/2001 called "Brussels I", which covers the same field. This Regulation aims to determine the competence of the legal organs of the member states linked by the Regulation and to help the speedy recognition and enforcement of legal decisions, public registers and transactions[61]. In terms of its scope, it covers most civil and commercial matters, except revenue, customs or administrative matters. It also does not extend the status or legal capacity of natural persons, rights in property arising out of a matrimonial relationship, wills, successions, bankruptcies, social security or arbitration.

By contrast, the United States is not party to any international convention. An individual or company which wants to enforce a foreign judgement, order or resolution has to file a suit before the competent court. This court will determine whether or not to execute the judgement. In 1976 the United States began negotiations with the United Kingdom, but they ended in 1981 without a final text being agreed on. The US also participated in the negotiations on the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards. However, it has not signed the treaty yet.

In terms of bilateral negotiations, the main aim of the European countries in their negotiations with the United States is to eliminate certain rules on competence which are considered excessive, such as the practice known as

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[60] At present, Iceland, Norway, Liechtenstein and Switzerland.

[61] Denmark did not participate in passing the Regulation, and thus is not subject to it. Its relation with the other Member States signatories to the Regulation is regulated through the Brussels Convention and its 1971 Protocol.

doing business in an American state or the *American rule*. The subject is complex, among other reasons because the American rules governing jurisdiction leave the drawing up of applicable rules and principles to the individual states. The Supreme Court has ruled that to obtain state jurisdiction over a non-resident, it is sufficient for this non-resident to have "minimum contacts" with the state, i.e. that he or she receives some benefit in this state from the activity he or she carries out.

Unlike American practice, in the European case there must be a substantial connection with the country in which the action is undertaken. The fundamental principle in Europe is that the competent jurisdiction is the member state where the defendant is domiciled, whatever his or her nationality[62]. The determination of the domicile depends on the law of the member state in which the court with jurisdiction is. For legal persons and companies, the domicile is defined according to the place in which the registered office, headquarters of main establishment is. For groups, the domicile is defined by the judge in the member state whose court has jurisdiction. The judge applies the regulations of its international private law.

In addition, according to the American rules the costs of proceedings are assigned pro rata independently of the result of the case, while in Europe the usual rule is that the loser pays the costs, although there are numerous exceptions depending on the interpretation of the law or the reasonableness of the loser's demands. Thus, according to the characteristics of the case, the costs for a European party could be different according to where the case was filed. This means that in certain jurisdictions more pressure could be applied to come to a compromise agreement.

Unlike the European objectives, the American objectives in negotiations to reach an international agreement have to do with the enforcement of judgments

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[62] There are also special rules on jurisdiction related to contracts (except employment contracts), food requirements, criminal or quasi-criminal activities, claims for damages resulting from infractions, use of branches, agencies and other establishments, payment claimed for help in salvage operations, and other specific regulations for insurance, contracts with consumers, individual employment contracts, exclusive jurisdiction, the extention of jurisdiction, and provisional and cautionary measures.

abroad. The process of recognizing and enforcing legal decisions generally refers to the process by which a court accepts as binding a decision granted to the claimant in legal proceedings abroad, and enforces compliance with it.

In Europe, the regulations on individuals aim to simplify the procedures necessary to recognize and enforce the judgements of a court in a member state through a simple and unified procedure. They are based on the following fundamental principles: i) Any judgement given in a member state is automatically recognized in other member states, without any special procedure being necessary ii) in case of conflict, the parties may use the specific procedure to obtain a declaration on the enforcement of a judgment given in another member state.

In this context, what the Americans are looking for in the way of an international commitment would be to facilitate the enforcement abroad (especially in Europe) of judgments handed down by American courts. Europe would place less emphasis on this question because the enforcement of European court decisions in the US tends to be easier and generally does not depend on the existence of a reciprocity requirement (as in the majority of European states)[63].

Among the results which would be achieved by an agreement between the EU and US to mutually recognize judgements is the expansion of bilateral trade, which is today to a certain extent restrained by the increasing frequency with which there are trans-national lawsuits. It would also supply a homogeneous treatment of the problem, which does not yet exist, since there are countries and states which already recognize and enforce foreign decisions (this is the case of many states in the US). The aims of the agreement are:

— that a final judgement in a suit brought before a foreign court is recognized by a local court;

— that a foreign judgement can be enforced by a local court through the use of its power to recognize the decision of the foreign court.

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[63] Recognition and enforcement in the local US context has a close relation with the "full faith and credit" clause recognized by the US Constitution, which requires that there be recognition by state courts of final and valid judgements of other state courts.

Some of the requirements to bear in mind for recognition when reaching an agreement are: a) that there should be adequate notification of the final judgement; b) that the judgement should have been issued by a competent judge; c) that the judgement should be final and binding, and d) that it does not conflict with the policy of recognition of the country in question.

However, there are significant obstacles in this, mainly because of the peculiarities of some legal systems. Among these obstacles are:

a) The lack of jurisdiction of the local body: some countries such as France or Sweden do not enforce a judgement against their nationals unless there is a clear indication that the national agreed to submit himself to the jurisdiction of the foreign court at the time.

b) The existence of a treaty between states. Some countries such as Holland do not enforce a judgement if there is no agreement with the country in which it originates;

c) Compliance with informal requirements: there are countries such as Germany which are not parties to a specific treaty but which nevertheless demand reciprocity in the recognition and enforcement of judgements.

d) Confusion because of lack of legal uniformity: in the case of the United States it can be difficult to clarify federal policy on recognition and enforcement, given the existence of numerous sub-federal approaches;

e) Appeal to the public interest: some local policies may be considered by foreign courts as contrary to public policy in the given country (e.g. in cases of damages or punitive damages).

In any event, the main objective of an agreement on jurisdiction, recognition and enforcement of judgements is to increase legal cover and the security of court decisions in the international context to the benefit of individuals and economic agents. The way of doing this is to offer solutions that are simple, efficient and easily applied by judges and lawyers, and to find a balance between the interests of plaintiffs and defendants.

Divergent approaches to climate change policies

It is well known that the European Union and the United States disagree on climate change policies[64].

This is already a source of market disintegration since, for example, US-based firms are now affected by the tangible implications of the Kyoto Protocol and the EU emissions trading scheme (ETS). No further integration of EU and US markets can take place without a resolution of the climate change squabble. A fragmented or even disintegrating regulatory framework on greenhouse emissions on both sides of the Atlantic would be very negative to the transatlantic economy.

EU member states agreed to implement the Kyoto provisions. The US did not. In fact, the US rejection of the Kyoto Protocol has been used by anti-American Europeans to reinforce their efforts towards a creating transatlantic drift. However, European governments originally opposed the market-based carbon trading system that the US wanted.

More recently, in July 2005, the US signed an agreement with an important number of Asian countries based on an alternative approach to policies fighting climate change: the promotion of energy-saving and non-fossil-based new technologies.

The 2005 Montreal summit has produced some valuable results: the so called "Kyoto-2" agreement and the commitment of the US to get involved in a system of global targets for cutting emissions.

The European implementation of the Kyoto Protocol has been very poor, leading to absurd outcomes. For instance, one outcome of the EU emissions trading scheme is quite clear: certain EU member states with lower-than-average greenhouse gas emissions per capita will have to transfer enormous amounts of money to higher-than-average member states.

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[64] Cfr. Christian Egenhofer (2005), "*Climate Change: Could a transatlantic greenhouse-gas emissions market work?*", in Hamilton and Quinlan, op. cit., which includes recent data on this controversy.

In addition, these net contributors are member states with lower-than-average levels of income per capita. Does this make any sense? Should the defenders of the EU ETS be proud of this "brilliant" outcome?

Moreover, pro-Kyoto pundits obscure the fact that the Kyoto Protocol is actually in rather poor shape. All countries face major challenges in meeting their targets. Important European voices are openly asking for the reconsideration of the Kyoto Protocol[65] as far as Kyoto-2 is concened. The recent report of the Select Committee of the House of Lords on Economic Affairs[66] is a good example.

If Kyoto-2 is to survive, deep reforms of the current system will be needed.

Differing standards

Differing standards are often the source of trade barriers across the Atlantic. When they do not generate barriers, they can translate into lower economies of scale, hindering the global competitiveness of both the EU and the US economies.

To give a few examples, there are the different standards for sizes in shoes and textiles. Different electric standards (110V, 220V) also mean electrical equipment is not able to run in both markets. The same applies to incompatible traditional TV standards (PAL, SECAM).

Markets for services also face hurdles and lower competitiveness resulting from different and incompatible standards. Telecommunications services are a good example: GSM in Europe vs. CDMA in the US; or UMTS vs. CDMA-2000. The same applies to digital terrestrial television. ATSC technology in the US and the DVB-T in the EU are incompatible standards.

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[65] Cfr. Purvis, N. (2005), "*Climate Change Policy: Next Steps"*, Brookings Briefing, The Brookings Institution, Washington, DC, February 9, 2005 and Fiona Harvey, "Business pushes G8 on global warming*", Financial Times*, June 10, 2005.

[66] Cfr. Select Committee of the House of Lords on Economic Affairs, 2nd Report, HL Paper 13, 6 July 2005.

MOBILE TELECOMMUNICATIONS STANDARDS

3G has been a failed attempt to close the old debate on the incompatibility of US and EU standards for mobile communications.

For 3G platforms, the International Telecommunications Union adopted five families of standards: the UMTS (or WCDMA), the CDMA-2000, the TD-SCDMA, the UWC-136 and DECT+. Currently, 3G commercial mobile services are based on either the UMTS, the CDMA-2000 or the TD-SCDMA.

The EU, in line with its traditional committee-driven regulatory approach to the standardization of technologies, adopted GSM as the harmonized standard for 2G mobile services. In 1998, the Commission chose UMTS as the 3G standard for the EU.

Unlike the EU, and in line with its traditional regulatory approach, the US adopted a market-driven strategy to standardization. This strategy led to the emergence of three incompatible standards for 2G: GSM (Cingular, T-Mobile), CDMA (Sprint, Verizon) and iDEN (Nextel). In 3G, though CDMA-2000 was expected to become the main standard, AT&T Wireless (later acquired by Cingular Wireless) announced in 2004 the commercial availability of UMTS in some key US cities.

In China, the powerful China Academy of Telecommunication Technology made the strategic decision to implement a third standard: the TD-SCDMA.

The final outcome is that Europe and the US have different standards and face increased competition from China, which has benefited by implementing a third standard.

No agreement on security measures

The EU and the US must ensure that trade facilitation and security are mutually supportive to avoid adversely affecting legitimate trade. There should be the least impact possible by national security on trade at all levels.

Acquisition of visas takes too much time. This translates into increased costs for companies and citizens. The problem of mobility in the transatlantic marketplace has become especially acute for business staff. The increased

time and costs involved in acquiring business visas have thus become a significant transatlantic barrier.

Without relaxing security standards, trade facilitation can also be improved in areas such as export controls on the dual use goods and customs procedures.

Professional services

The conditions required by colleges or associations of doctors, lawyers, architects or engineers from people wanting to exercise their chosen profession often become protectionist measures.

There are now three levels of barriers to trade in services. Thus, removing the current barriers on the trade in services requires action in several directions. We will use the example of regulated professional services that can only be legally provided if the professional holds an official certification enabling him or her to provide this kind of service. This holds true, for example, for colleges or associations of doctors, lawyers, architects, or engineers, which demand a set of conditions that can often become protectionist measures.

It might be thought that mutual recognition of professional certifications might solve the problem. However, this is not the case. Mutual recognition of certifications is a necessary condition for open markets for services, but it is not sufficient. Recognition of professional certifications is not much use if there are citizenship clauses, or if entry of foreign professionals is restricted as a result of immigration law. Mutual recognition helps in removing “pure” regulatory barriers, i.e. qualitative barriers. But apart from that, for mutual recognition to be effective we must guarantee that discriminatory barriers such as the national treatment rules (applied to both nationals and foreigners equally, but resulting in trade obstacles) and quantitative barriers (entry or establishment restrictions) are removed as well.

To sum up, removing barriers to trade in services in the transatlantic economy means that progress is needed towards the mutual recognition of certification, but it also requires complementary actions to ensure market access and the removal of special treatment.

The EU Single Market Programme provides guidance on how to proceed with liberalizing these sectors, and lessons learnt from this programme could be usefully applied to EU-US relations.

Limits to electronic commerce

The EU and the US face common problems in areas such as e-commerce, Internet governance and anti-spam legislation.

Fraud in e-commerce and spam have become serious problems, while criminal activities such as child pornography or the malicious spreading of harmful viruses through the Internet are a major source of concern.

Excessive intellectual property rights

The controversy over intellectual property rights (the optimal balance between the benefits of patent protection and the benefits of the diffusion of technology) goes on. As technology progresses, it extends to new areas, such as software and information technologies. For example, there is now a new controversy on the importance of interoperability of IT standards, on the one hand, and intellectual property issues raised by the so-called "proprietary formats" in IT on the other.

In general, we should avoid excessive protection resulting from the granting of patents for any procedure or idea, and the excessive prolongation of intellectual property rights. Excessive protection can slow down technological progress.

Patent protection is probably used too much in some areas. The jurisprudence based on the US Constitution is of interest as a possible conceptual reference on this question.

An appropriate balance between the protection of intellectual property rights and the promotion of new technologies must be found, often on a case-by-case basis.

Of course, there is no doubt that counterfeiting and piracy are economically and socially harmful practices. Losses from counterfeiting and piracy can be clearly

identified. Besides the direct losses they cause to IPR owners, they lower incentives to create new knowledge and reduce the rate of technological innovation.

Thus, in addition to the EU and the US being the two economic areas most harmed by illegal flouting of intellectual property rights in third countries, threats to intellectual property rights are an important source of distortion of the EU and US markets, and of transatlantic trade.

However, there is no precise quantitative assessment of the economic impact of counterfeiting, though the OECD has organized an interesting project to tackle this issue.

Attacks on intellectual property are especially harmful in the cultural and leisure industry, like the music industry, and in the software industry. However, other sectors are affected as well, in cases such as the differentiated products of internationally famous brands.

Conflicting corporate governance and accounting standards

Scandals such as those affecting Parmalat, Enron or Andersen have shown the degree of interconnection and interdependence between the economies of both sides of the Atlantic, and also how much respective regulators need to cooperate to create timely and effective solutions capable of improving transatlantic auditing and corporate governance rules.

Such scandals involved questionable dealings (SPEs, improper swap arrangements and flaws in financial disclosure) that took on a global dimension. These episodes led to a variety of responses form regulators and brought the issue of transatlantic governance and accountability to the attention of lawmakers and public opinion.

The US Congress approved the Sarbanes-Oxley Act in 2002. EU policy-makers quickly responded to the US scandals by accelerating their own modernization of company law.

The *Sarbanes-Oxley Act* was designed to improve the corporate governance and accountability of boards, managers, and gatekeepers by increased

surveillance and monitoring of US-listed companies and reputational intermediaries. Such a measure was seen by some in the EU as a new barrier dividing the economies on both sides of the Atlantic.

These high-profile corporate fallouts of recent years, and the uncoordinated reactions in the US and EU, prove there is a need for appropriate cooperative regulation.

As Khachaturyan and McCahery point out, in 2002 the EU and the US launched the Regulatory Cooperation Guidelines and the Financial Markets Regulatory Dialogue (FMRD) to promote transatlantic trade establishing better quality regulation and minimize the divergences in the laws and policies of both jurisdictions. In the same way the Regulatory Dialogue was established as a meeting for discussing bilateral corporate governance and financial market regulation[67].

The Sarbanes-Oxley Act applies to non-US firms that are listed on a US exchange. It forces EU audit firms to register with the Public Company Accounting Oversight Board (PCAOB), a costly procedure that could eventually force these companies to de-list from major US markets. This requirement has generated widespread criticism in Europe.

However, in spite of the political initiative supporting cooperation, in the wake of the Parmalat scandals in Europe, the negative EU reactions to the US Sarbanes-Oxley legislation turned into a close examination of US regulations and the lessons that could to be learned in terms of good practice for European corporate governance.

EU policy-makers accelerated their own company law modernization and corporate governance reform programme, which had already been set up by the Commission through a High Level Working Group. EU regulators were motivated by a concern to ensure that US collapses should not be replicated in Europe, but also by the need to give credibility to claims of regulatory parity in the light of negotiations over the extraterritorial impact of US law.

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[67] Cfr. Arman Khachaturyan and Joseph A. McCahery (2005), "*Transatlantic Corporate Governance Reform: Brussels Sprouts or Washington Soup?*", in Hamilton and Quinlan, op. cit.

Taking up the recommendations of the High Level Group, the EU launched its Action Plan in May 2003. The Action Plan is intended to give an ambitious impetus to EU company law harmonization by meeting three challenges in the area of corporate governance: i) improving the integrity and accountability of board members, ii) restoring the credibility of auditors and iii) promoting fair presentation of the company through sound and reliable accounting and hence, restoring investor confidence and fostering efficiency and competitiveness of businesses in the EU.

The EU and US should reinforce mutual cooperation and recognize equivalent rules on either side of the Atlantic in corporate governance and related matters. Corporate governance policies in the EU and the US should take into account the global environment in which companies function. Any additional regulations should be well judged, with an assessment made of the effects of new corporate governance regulations on the transatlantic economy.

In conclusion, despite additional efforts to develop a "transatlantic practice" on these questions, there are still too many reforms to complete. For instance, corporate law remains a domestic matter. It is particularly striking the case of the EU, where low coordination between member states make it impossible to provide some minimum standards. Impediments remain on both sides of the Atlantic. An international regulatory and supervisory system of cooperation on accounting and auditing is needed, and so far it has not been attained. If authorities at both sides of the Atlantic don't want to miss the opportunity, isolated regulative initiatives in this field must be abandoned, and instead, cooperation and agreement must be at the top of their agendas.

In the short term, the US and the EU should make a special effort to find a solution to the tension resulting from Section 404 of the Sarbanes-Oxley Act as well as from the "300 shareholders" threshold for EU companies wanting to de-list and to terminate US reporting requirements.

With regard to accounting standards, full convergence between US Generally Accepted Accounting Principles (US GAAP, enforced by the SEC) and International Financial Reporting Standards (IFRS) is key for US and European companies. After a long period of discussions, the US Securities and

Exchange Commission (SEC) and the European Commission agreed on April 22, 2005 on a system of equivalence of accounting standards. A specific bilateral group should accelerate this work so as to attain full convergence within a reasonable time scale. The US and Europe should have essentially equivalent standards by 2009.

SECTORAL ANALYSIS

The analysis of horizontal barriers to trade can be complemented by a sectoral analysis. The list of sectors which could be analysed is, of course, enormous. Here we will limit ourselves to four sectors, chosen for reasons we will make clear.

The first sector we have chosen is the automotive, because it is one in which there is trade in goods, and various kinds of barriers: tariffs, regulatory barriers and standards. The second sector is telecommunications, because it deals with trade in services, and is affected by regulatory barriers and a dynamic problem of standards. The third sector is financial services, which is affected by a variety of factors, and which is also extremely important in the economic system as a whole. Finally, we will deal with air transport. This combines factors such as its recent structural transformation and its opening up to competition, its exposure to changing regulations, and its relative fragmentation, posing different problems for transatlantic integration.

The automotive sector[68]

Europe and the US were the original centres of the automotive industry and remained dominant until the 1960s. The emergence of Japanese industry in the 1960s and 1970s and the Korean industry in the 1990s has changed the picture.

Because of a larger market and the absence of different national regulations, US manufacturers were much more efficient than European manufacturers and cars in the US were in average a 50% cheaper than those in Europe. It is not strange that Europeans were among those who imposed high tariffs on foreign car makers.

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[68] For a good and recent survey on this industry, cfr. Garel Rhys (2005), "*The Transatlantic Automotive Sector*", in Hamilton and Quinlan, op. cit.

These EU tariffs were partially eliminated under successive GATT agreements (the Dillon, and particularly the Kennedy), although they remain at around the 10% level. Even today EU tariffs are much higher than US tariffs on passenger cars. European cars face a 2.5% import duty at the US border whereas American cars encounter a 10% tariff in Europe.

There are no quotas or voluntary export restraints between the EU and US. However, EU and US safety standards are different, and result in some trade barriers. Technical regulation on gas emissions is also different and imposes minor trade barriers.

Consequently, we can say there are no major barriers to the transatlantic trade in cars. It is a good example of how multilateral negotiations and WTO-plus cooperation have resulted in market integration. American car producers established in Europe are widely accepted as European manufacturers as their cars are designed and manufactured in Europe with European suppliers.

Those who have benefited most from the opening up of the EU and US markets have not been American manufacturers but Asian ones, Japanese and Korean in particular, who have been able to sell cheap cars in Europe. The US has remained an open and liberalized market able to absorb a large and growing number of imported cars.

Balance of payments in automotive products ($million)

	1990		2003	
	Exports	Imports	Exports	Imports
US	32,547	79,320	69,245	181,283
Europe	45,751	23,329	124,973	66,523
Japan	66,230	7,315	102,734	11,130

Source: WTO

The imbalance in trade is not due to the tariff discrepancy, but rather to the kind of vehicles that are made in both continents, which are basically different. In fact the American models are cheaper than European ones, but

they are less cost-efficient in terms of fuel consumption, and their life expectancy is on average lower.

Integration of these markets has again been done through investment rather than trade. US firms have traditionally preferred to market European-made cars through their subsidiaries rather than selling American models.

The move of Daimler Benz to acquire Chrysler can be considered an exception but, at the same time, it is a good example of a successful Euro-American company. Although car models remain different on both sides of the Atlantic, the components and materials used benefit from a common platform and engineering design that makes products more competitive globally.

It is inevitable to wonder whether the car markets in America and Europe are tending to converge or, on the contrary, whether they will remain quite differentiated in the long term. The answer is not easy. A larger market would lead to gains in efficiency from which customers and manufacturers would benefit, but the demands of final users are still very different and so are elements like fuel costs. Indeed, these costs have led to a shift in the proportion of diesel cars, and 2005 will be the first year in which diesel models lead the market in Europe. In America diesel models still represent a very small proportion of cars sold. Furthermore, in Europe 80% of the cars have engines of less than 2 litres. In America, 80% of the cars have engines of more than 2 litres.

Telecommunications services

Transatlantic telecommunications services (voice and data traffic) are key inputs for much other productive business, and a key to the transatlantic market itself.

The transatlantic market for telecoms has been made possible by both national liberalization of old public monopolies and international agreements under the WTO negotiations.

The US Execunet Decision of 1977, the break-up of AT&T and industry restructuring from January 1984 under Judge Greene's MFJ and the series of

pro-competitive decisions of the FCC and the courts in the US opened up US markets to competition[69].

In Europe, the UK was the first European country to head for a multi-competitor industry structure as a result of the 1984 Telecommunications Act, leading to British Telecom's privatization and the licensing of competitors. Sweden soon followed along this path. At the end of the 1980s, both countries moved to a more radically pro-competitive approach, establishing open entry into the domestic fixed-service market.

The success of the Anglo-Saxon model led the European Commission to implement deep reforms so as to remove public monopolies and to ensure a single market for telecoms services as from 2002.

At the international level, opening up markets involves both technical and commercial issues.

Pure technical and operational issues[70] are agreed within the International Telecommunications Union (ITU), the Internet Engineering Task Force (IETF) and *ICANN* (Internet domains).

Commercial issues are dealt with within the WTO negotiations. This is particularly true of market access and participation across national frontiers.

The WTO Basic Telecommunications Agreement[71] is a complex set of bilateral and multilateral agreements. Under it, American and European governments made the most far-reaching market-opening commitments

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[69] Tyler, M. and Dixon, M. (2005), "*Transatlantic Telecommunications: Markets, Policies, Issues*", in Hamilton and Quinlan (2005), op. cit., and Renda, Andrea (2005), "*Telecommunications Services: A Transatlantic Perspective*', in Hamilton and Quinlan (2005), op. cit.

[70] Such as technical standards and compatibility, numbering and the use of radio frequencies.

[71] Technically, the WTO Basic Telecommunication Agreement is a protocol to the General Agreement on Trade in Services (GATS) and was adopted as part of the WTO Treaty (the Marrakech Agreement). The agreement was concluded in 1997 and came in to force in 1998, with defined "schedules of commitments". The EU acts on behalf of all Member states in WTO negotiations, including telecoms services.

concerning rights of entry for foreign competitors to domestic and international fixed markets, rights of foreign operators to establish networks and non-discriminatory interconnection at cost-based prices.

The major success of the WTO BTA has been to be able to extend the rights of unrestricted licensing and interworking with the incumbent's networks on a non-discriminatory basis to telecoms operators of signatory countries.

Technical progress has resulted in both productivity gains[72] and in successive crises which have made clear the need for reform within the telecoms industry.

In the nineties and the first years of the new millennium, universalization of the Internet and mobile telephony, new satellite services and closer interconnection between telecoms, IT and the audiovisual industry known as technological convergence have resulted in profound reforms for the telecoms industry, as well as for its new industry neighbours, IT firms and broadcasters.

The key factors driving the industry today are: the ongoing transition from wired to wireless telephony (the so-called fixed-mobile substitution); the convergence of voice and data communications services with the emergence of Internet voice telephony (VoIP); the mobile sector's rapid movement towards broadband, making it a substitute for fixed voice and data services; and increased convergence between end-to-end communication technologies and broadcasting services.

However, we should point out that integration has not reached the area of market structure.

Cooperation in the nineties dealt with international alliances pooling or sharing transmission capacity and certain classes of traffic and revenue. Examples are Concert (led by AT&T and BT) and Global One (led by France Telecom, Deutsche Telekom and Sprint). However, they were unsuccessful. Both Concert and Global One disappeared in 2001.

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[72] Cfr. Jorgenson, D. (2001), "Information Technology and the U.S. Economy", *American Economic Review*, Vol. 91, No. 1, March.

More recently, in 2005, Deutsche Telekom's T-Mobile acquired Cingular's networks in California and Nevada and currently operates services in both states.

Despite of the fact that nine out of the ten biggest telecom companies in the world (NTT Japan, Verizon US, France Telecom, Deutsche Telekom, Vodafone, SBC, AT&T, Telecom Italia, BT, Telefónica) are based either in the United States or in the European Union[73], and the US and the EU jointly account for 63% of the world's market[74], no US or EU company is operating on both continents to any significant extent (maybe with the exception of Vodafone). Moreover, no Euro-American telecoms operators currently exist, in spite of voice and data traffic being mainly commodities services.

On the positive side, leased-line resale, refile, hubbing and re-origination have helped to bring about competition in fixed-line telecoms services.

However, the surge in mobile telecommunications and fixed-to-mobile substitution poses an important challenge to the transatlantic economy, as national markets for mobile services very much resemble oligopolies: a few operators (three is the most common figure) with insurmountable barriers to entry resulting from the radioelectric spectrum being a scarce resource managed by a monopolistic owner: the State.

The context becomes even more complex as a result of different mobile telecommunications standards: GSM, CDMA, in the so called second generation (2G) mobile communications; UMTS (WCDMA) and CDMA-2000 in the so called third generation (3G) mobile communications. Convergence in the mobile sector will be boosted by the introduction of 3G platforms, which reduce (but not eliminate) the problem of incompatible standards on both sides of the Atlantic.

With regard to barriers, following ratification of the WTO Basic Telecommunications Agreement by both the US and the EU, the principles of

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[73] OECD, IT Outlook (2004) and OECD, Key ICT Indicators (2005).

[74] European Information Technology Observatory (2005), "*2005 Annual Report*", Frankfurt. Europe accounts for 30.7% and the US for 21.6% of the €1.126 trillion global telecoms sector

national treatment and most-favoured nation apply to the market-opening commitments made under the Basic Telecommunications Agreement, like all WTO agreements.

However, an integrated transatlantic market on telecommunication services is still hindered by diverging regulatory frameworks, incompatible standards and a large number of opaque barriers[75].

The main and most worrying barrier results from some EU member states refusing to privatize their incumbents. Conflicts of interest arise, since the decision-makers in regulatory bodies are appointed by the government, and incumbents are owned by the State. The absence of neutrality in decisions by regulators regarding market entry of foreign competitors is a logical outcome of this conflict. Protectionism is hidden behind regulatory decisions. Let us take the example of a State-owned incumbent refusing to offer foreign competitors access to private circuits and ISDN lines. If the regulator is not neutral, this means higher costs for foreign rival operators. In other words, we are talking about protectionism.

Secondly, "the devil is in the details", as the saying goes, i.e. in the commercial protection measures. Thus, certain safeguards against "anti-competitive behaviour" by foreign operators[76] are sources of covert protectionism, even if they have been declared to be non-discriminatory under the WTO Basic Telecommunications Agreement. These safeguards deter competitive entry. They also deter investment by creating legal uncertainty.

Another sort of barrier results from radio spectrum licensing decisions by national regulators and authorities, which on some occasions are not fair to foreign telecoms operators.

Incompatible standards represent insurmountable barriers both in the European and the US markets for mobile telephony and digital terrestrial television.

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[75] See European Commission (2004), '*2004 Report on US Barriers to Trade and Investment'*, Brussels, December 23, 2004.

[76] FCC's recent consideration of Deutsche Telekom's acquisition of WorldStream may be a good example.

Pure regulation may also lead to market barriers. Take the example of regulation of termination charges. The National Regulatory Authorities" (NRA) decisions on the regulation of mobile termination charges for 3G mobile operators, for example, may deter market entry. Moreover, given Europe's current calling-party-pays regime, it could be argued that all mobile operators hold significant market power in the market for mobile termination.

In the area of spectrum policies, the allocation of different bands for 2G has posed important difficulties for mobile services. The 2G band adopted in the US (in the 1.9 GHz range) prevents the use of this band in many EU member states, and multiband equipment is required. 3G licenses have not been allocated in the US, and the 3G spectrum will not be auctioned before summer 2006.

Slow market liberalization in Europe, especially in fixed-line communications, also results in barriers to market entry.

There are still some remaining restrictions on foreign ownership. Some of them result from the so-called "effective competitive opportunity test" (ECO-test). In 1995, the US FCC adopted a rule on the entry of foreign affiliated carriers into the US market, by introducing the ECO-test. After the GATS-WTO BTA, the US replaced the test with a neutral principle, but retained a "public-interest" criterion granting the FCC legal authority to deny a licence to a foreign operator in the light of "trade or foreign policy concerns", or a "risk to competition". These rules are effective barriers to foreign entry into US markets.

In spite of the commitments undertaken by the US within the GATS-WTO BTA, FDI in US companies holding common-carrier radio licences is limited to 20%. A similar rule applies to the broadcast sector.

In addition, the US keeps market access restriction on satellite-based services. Foreign satellite operators face substantial barriers to entry. There is also an MFN exemption to one-way satellite transmission of direct-to-home, direct-broadcast-satellite and digital audio services.

Financial services[77]

Numerous barriers still remain in the transatlantic market for financial services, impeding the integration of the EU and US capital markets. Barriers prevent transatlantic financial markets from operating seamlessly.

The US Securities and Exchange Commission (SEC) and the European Commission agreed on 22 April 2005 on a system of equivalence of accounting standards. However, the agreement has significant barriers preventing it from being fully effective. Firstly, financial markets are substantially different on both sides of the Atlantic. Secondly, the process may be seen as a way of reducing regulatory competition.

There are structural differences between the US and EU financial systems. As Daniel S. Hamilton and Joseph P. Quinlan describe[78], while a bank-based system is predominant within the EU, the US has a market-based one. The two systems differ fundamentally. The EU is characterized by a highly developed banking market and a much less developed bond and equity market,[79] while the opposite is true for the US[80]. Even within the EU, differences between the

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[77] Cfr. Karel Lannoo (2005), "*A Transatlantic Financial Market?*", in Hamilton and Quinlan, op.cit.

[78] Cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (eds) (2005), "*Deep Integration: HowTransatlantic Markets are Leading Globalization",* Washington, DC and Brussels: Center for Transatlantic Relations and Centre for European Policy Studies.

[79] The universal banking system has remained dominant in the EU. The EU´s 1992 program of financial market liberalization did not foster debt securitization, and financial markets remained underdeveloped. In addition, the regulatory framework differed from one country to another. In order to secure the benefits of economic and monetary union, a new system of financial lawmaking and supervisory cooperation was adopted as suggested by the Lamfalussy report, after having been adopted the *Financial Services Action Plan (FSAP)* in 1999. By mid-2004, a new regulatory framework was in place for issuing securities on capital markets (Prospectus Directive, 2003/71/EC), market disclosure (Transparency Directive, 2004/109/EC), tackling insider trading and market manipulation (Market Abuse Directive, 2003/6/EC), and promoting fair trade and the best execution of securities transactions (Markets in Financial Instruments Directive, 2004/39/EC). The effects of these directives should allow a more market-based system to develop. A market-based system is expected to be developed in Europe as a result of such initiatives. See Karel Lannoo (2005), op. cit.

[80] In the US, the 1933 Glass-Steagal Act separated commercial banking from investment banking. Additionally, the 1933 Securities Act laid the basis for the market-

financial structures of each nation appear, showing, for instance, a more developed and competitive commercial banking system in Spain than in Italy.

The asymmetry between the US and EU systems could be the result of regulatory differences. However, structural differences are not necessarily only caused by artificial regulatory barriers. The comparative advantage principle may be operating in a certain regulatory environments, which are always different from one country to another.

What is even more important is that different structures are perfectly compatible with an integrated market. What worries us is market barriers and disintegration, and nothing else. And the evidence shows that the current levels of capital market fragmentation adversely affect the debt and equity markets, impede the competitiveness of the financial services industry, diminish credit rating transparency and limit access to finance across markets.

We are still far from the full liberalization of capital market transactions. There is still no free movement of capital with equal access for operators to capital markets in both the EU and the US.

There is a need to implement international financial reporting standards. This action would be a great help in promoting confidence in financial reporting, and it is also necessary to achieve greater integration of capital markets.

Convergence in EU-US listing rules is needed. This involves EU-US agreements treating listing and de-listing rules as equivalent in the respective jurisdictions in pursuit of finally agreeing convergent approaches.

Building a truly integrated transatlantic capital market also requires action on regulation of admission to trading platforms.

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based system as it is known today. This legislation fostered competition between intermediaries, leading to the creation of the most competitive financial industry in the world. Competition between commercial banks, investment banks and brokers in the US favoured a process of disintermediation and securitization.

A coherent international business and governmental focus on good corporate governance is essential for both transatlantic and global trust. We have already referred to this issue.

Air transport[81]

Although air transport is a key service for Atlantic market integration and international trade, paradoxically the air transport industry remains subject to highly restrictive national controls on cross-border competition and investment. As an editorial in the *Financial Times* put it, "In an era of supposedly borderless markets and global competition, the world airline industry remains stuck in a time warp"[82].

For decades, arcane rules and fare-setting arrangements have distorted the market for aviation both in the EU and the US. Restrictions on foreign ownership of airlines, in the name of national security, have prevented the competition that has preserved the vitality of other industries.

Airlines have traditionally sucked up government money and disappointed investors. Now many of America's leading carriers are dependent on Chapter 11 bankruptcy protection, while many of Europe's flag carriers do little better than break even. But as passenger numbers have increased over the years, a few have made handy profits since their release from state control. And a whole squadron of low-cost airlines are prospering, despite the industry's regulatory thicket[83].

At a domestic level, both the US and the EU have already relaxed their grip.

The US began the process of liberalization in 1978, opening up the market for flights within the country. New, low-cost airlines flying passengers at rates set by the market proliferated.

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[81] Cfr. Dorothy Robyn, James Reitzes and Boaz Moselle (2005), "*Beyond Open Skies: The Economic Impact of a US-EU Open Aviation Area*", in Hamilton and Quinlan, op.cit..

[82] See "Lowering the flag", *Financial Times*, June 2000.

[83] See "Freeing the airways", *The Economist*, 11 November 2005.

Europe had to wait until 1997 for deregulation. The results were similar: a big number of low-cost airlines began flying customers cheaply all over the European Union. Europe boosted some 50 no-frills airlines.

US' commitment to more flexible flying also extends to a series of bilateral deals with some European countries and a host of other destinations. America now has arrangements with 72 countries. These allow its carriers to fly from anywhere in the US to destinations in the other country in return for allowing that country's carriers direct flights to more US airports. And big European carriers have been permitted to forge close flight- and revenue-pooling alliances with US partners.

By prohibiting foreign competition in internal markets through actions such as opaque slot-allocation procedures, bilateral agreements, restrictions to cross-border investment in foreign carriers, the global air industry is not enjoying the benefits of an Open Aviation Area. Despite some efforts towards "open skies", many restrictions remain. At the top of the list are "output-restricting bilateral agreements. Ten of the 25 EU member states have not signed open-skies agreements and still use bilateral ones, thus limiting the volume of traffic to and from the US.

The most restrictive bilateral agreement is Bermuda 2, which regulates US-UK aviation, the largest single transatlantic aviation market. This agreement restricts access to Heathrow (London's preferred airport) to two airlines each from the UK and the US, limits the number of US cities eligible for non-stop services from Heathrow and Gatwick airports, and limits entry to most markets to one US and one UK airline.

Another example of this air transport regulation is the US-Ireland air services agreement. Any US carrier serving Ireland must operate as many flights to Shannon as it does to Dublin. In turn, Irish carriers are limited in the number of US gateways they can serve.

Both examples show how the absence of an US-EU Open Aviation Area harms not only consumers but air carriers as well.

But even under an open-skies agreement, some barriers would persist.

With respect to transatlantic competition, the most striking one is derived from the "nationality clause", which stipulates that only airlines "substantially owned and effectively controlled" by nationals of the signatory State can operate a direct service between that State and the United States. This provision thwarts internal European liberalization and integration, acting as a barrier to airline consolidation in the EU and, consequently, preventing an efficient network design from emerging in Europe.

A second barrier within open-skies agreements is the statutory limit on foreign ownership and control of domestic airlines. Under US law, no less than 75% of the voting stock of a US airline must be owned by US citizens, and US citizens must also control the airline. In the same way, EU legislation restricts foreign participation to less than 50%, and some member states have their own restrictions on takeovers by non-EU investors.

Additional restrictions such as the stand-alone cabotage, consecutive (fill-up) cabotage, and "Fly America" requirements, as well as "wet leasing", are all included in open-skies agreements.

As we have argued, many efforts are still needed to foster cooperation and liberalization in the US-EU aviation industry. In chapter 5, we suggest some proposals for removing them.

CHAPTER 5.
THE ATLANTIC PROSPERITY AREA

HISTORICAL BACKGROUND

The United States and the European Union cannot be understood without each other. The US cannot be understood without Europe, and a free and democratic Europe after two world wars is a reality because of the US. The transatlantic link is part of the essence of both the European Union and the United States. They share core values, principles and objectives, and face the same threats.

1) Europeans and Americans share fundamental values on democracy, respect for human rights and individual liberty, promotion of peace and collective security and economic freedom.

2) Europeans and Americans face the threat of Islamic terrorism. After the 11 September 2001 terrorist attacks in the US, the 11 March 2004 attack in Spain and the 7 July 2005 attack in London, as well as several terrorist attacks in Turkey during 2005[1], the overall conviction is that global security threats are more effectively dealt with together than alone.

3) Europeans and Americans share the same concerns about global human challenges like poverty, pandemics and global warming.

4) The EU and US both need to improve energy efficiency, increase the diversity of energy sources and ensure a safe and secure form of energy supply.

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[1] It should be remembered that Turkey is already negotiating its accession to the European Union.

Thus the transatlantic relationship is part of the "genetic code" of both societies.

Moreover, while the Atlantic drift weakens both the EU and the US, and as President Bush as claimed, "when Europe and the US are united, no problem and no enemy can stand against us"[2].

The institutional framework for Atlantic economic cooperation

The reinforcement of transatlantic economic relations has been on the EU-US bilateral political agenda for the last fifteen years. Over the past ten years, the EU and the US have adopted some formal arrangements with the aim of structuring discussions over issues arising in trade, and as steps towards building closer cooperation.

But the framework of the EU-US economic relationship goes beyond trade and investment and includes a number of institutionalised dialogues and growing regulatory cooperation between the partners[3]. The EU and the US also cooperate in numerous multilateral organisations, as described in Chapter 7.

The New Transatlantic Agenda

In 1990, the EU-US Summit produced the Transatlantic Declaration, creating the basis for the following agreements.

THE NEW TRANSATLANTIC AGENDA

"For the last fifty years, the transatlantic relationship has been central to the security and prosperity of our people. Our aspirations for the future must surpass our achievements in the past"

3 December 1995

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[2] See www.whitehouse.gov/news/releases/2003/05/20030531.html

[3] See Annex 1.

In December 1995, the EU-US Summit launched the New Transatlantic Agenda (NTA)[4]. The NTA aimed to strengthen mutual economic relations, create new transatlantic bridges and expand global trade. One of the aims of the NTA is "to create a New Transatlantic Marketplace by progressively reducing or eliminating barriers that hinder the flow of goods, services and capital between us".

The NTA and the accompanying EU-US Joint Action Plan[5] of December 1995 created a senior-level dialogue structure and embarked on a series of specific cooperative endeavours[6].

Among these are the TransAtlantic Business Dialogue (TABD), a CEO-led private-sector group established by the EU and US administrations as part of the NTA to promote further transatlantic economic integration and to make specific recommendations to that end to the US Department of Commerce and the European Commission.

Some other dialogue fora have followed the TABD. They have covered environmental issues, consumer rights, employment and policy dialogue (e.g., the Transatlantic Policy Network, TPN).

The Transatlantic Economic Partnership

In early 1998, the EU Commissioner Sir Leon Brittan launched an ambitious proposal for a big step forward in EU-US relations. The New Transatlantic Market initiative (NTM) was based on a global vision of the transatlantic relationship, instead of the NTA's partial approach.

At the core of the NTM initiative was boosting global trade through the WTO by removing all industrial tariffs by 2010; creating a free trade agreement

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[4] See http://europa.eu.int/comm/external_relations/us/new_transatlantic_agenda/index.htm

[5] See http://europa.eu.int/comm/external_relations/us/action_plan/index.htm

[6] The New Transatlantic Agenda also provided a new framework allowing a move from consultation to joint action in four major fields (promoting peace, stability, democracy and development around the world; responding to global challenges; contributing to the expansion of world trade and closer economic relations; and building bridges across the Atlantic) to address differences more constructively.

between the EU and the US; removing all technical trade barriers through bilateral mutual recognition agreements; and other steps in the field of investment, intellectual property and public procurement.

However, this initiative did not see the light.

The EU-US Summit held in London in May 1998 tried to give a new impulse to the NTA. It saw the launch of the Transatlantic Economic Partnership (TEP).

The *Transatlantic Economic Partnership* (TEP)[7] lays the foundations enabling the EU and US to intensify their efforts to reduce or eliminate barriers to trade and investment between them, above all through closer cooperation between regulators. It allows them to focus initiatives on areas where there is goodwill on both sides and where gains can be enormous, such as financial markets; it promotes upstream convergence and mutual recognition of rules and standards; and it acts as an early warning mechanism if a potentially damaging piece of legislation is in the pipeline.

In November 1998 the European Commission and the US Administration adopted a rolling work programme, entitled the *TEP Action Plan*[8]. This document identifies areas for common actions both bilaterally and multilaterally. Some elements of the plan take the form of trade negotiations, while others are achieved through cooperative actions.

The TEP Steering Group (SG) was set up in order to manage day-to-day transatlantic trade and investment relations. It monitors the fulfilment of TEP objectives and provides a horizontal forum for bilateral consultation and early warning on any matter of relevance to trade and investment, with a view to preventing conflicts and resolving trade frictions. It is also responsible for implementing and developing the *Positive Economic Agenda* (PEA)[9], a series of positive and specific trade-related initiatives designed in May 2002 to promote cooperation and mutual commercial benefit. Activities under the PEA include the

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[7] http://europa.eu.int/comm/external_relations/us/economic_partnership/trans_econ_partner_11_98.htm

[8] See http://europa.eu.int/comm/external_relations/us/economic_relations/t_e_p.htm

[9] See http://europa.eu.int/comm/external_relations/us/ sum06_03/poseco.pdf>

implementation of the Guidelines on Regulatory Cooperation and Transparency, developed in 2002 under the TEP, and the Financial Markets Dialogue, a forum for the discussion of complex bilateral financial and regulatory issues[10].

No substantial advances in transatlantic economic cooperation took place in 2003 and 2004.

An assessment of the current Atlantic institutional framework

Though the TEP and its developments provide substantial instruments and institutions for economic cooperation between the EU and the US in many fields, this initiative worked well for a number of years, but has lost impetus in the last few years.

Exchanges between the US and EU have been more systematic and productive because of the institutions created by the NTA. Through them, regular dialogue is now established between interlocutors. But overall results can only be assessed as modest.

In fact, some people think that "the NTA often seems overloaded with too many issues"[11]. We do not share this opinion at all. The reverse is true, and the agenda should be even greater. The problem is that this Atlantic agenda is not being given the necessary political priority.

Some of the shortcomings of the NTA occur in many cases:

1. A lack of political commitment.
2. Major conflicts are not addressed in the NTA dialogue.
3. The absence of an overarching and strategic vision.
4. Its failure to involve legislators.

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[10] The single most important achievement of the PEA has been the launch of this regulatory dialogue, which has spurred exchanges between regulators on both sides on accounting standards and the implementation of the Basel II capital accords.

[11] Cfr. Peterson *et al.* (2005), "*Review of the Framework for Relations between the European Union and the United States. An independet study*", commissioned by the European Commission, Directorate General External Relations, Unit C1. Relations with the United States and Canada, Brussels.

The deeply integrated transatlantic economy is not matched by the policy framework and institutional structures necessary for effective governance. If the existing level of integration and its implications are to be managed successfully, it will require a substantial deepening of political cooperation between the United States and the European Union to mirror these realities. The strengthening of institutional structures for transatlantic political dialogue is essential. As some experts have recently stated, "leaders on both sides need to raise the political profile of the US/EU dialogue, and make it more strategic and effective". We also share the view that "doing nothing is not an option"[12].

On the eleventh anniversary of the New Transatlantic Agenda, there is a unique opportunity to adapt the TEP to the new realities so as to optimise the transatlantic relationship. In other words, a new transatlantic initiative is more necessary than ever. We think the NTA should be relaunched at the highest political level through a formal Treaty or Partnership Agreement: *the Atlantic Prosperity Area*. The APA should shift the EU-US dialogue towards one that is focused on major, strategic, global issues (such as the future of the multilateral trade system or fight against poverty).

Some are not in favour of "a comprehensive Treaty or Transatlantic Free Trade Area" because "there is danger in raising expectations beyond what is politically achievable". We consider that what is needed is political will to achieve a Treaty. It is politicians' time to make the proper decisions.

THE APA: AN INITIATIVE IN FAVOUR OF FREE TRADE

The APA proposes a removal of obstacles to the free and transparent functioning of the transatlantic market as a way of promoting greater integration of the Euro-American economy and of giving it a new dynamism. It is based on the solid basis of reducing and eliminating identifiable obstacles and distortions in transatlantic traffic, and of not creating new barriers against

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[12] Peterson *et al.* (2005), "*Review of the Framework for Relations between the European Union and the United States. An independet study*", commissioned by the European Commission, Directorate General External Relations, Unit C1 . Relations with the United States and Canada, Brussels.

third countries. The Atlantic area of freedom and prosperity must be open and integrated into the area of global prosperity which economic freedom will continue to build year after year. It is constructed on the firm conviction that transatlantic and global prosperity feed off each other.

The APA proposes to identify all the barriers to transatlantic trade and investment and eliminate them. It will do so in a rigorously coherent way, applying the same formulas – basically, unadulterated market forces– for both the national economies and the transatlantic economy.

THE APA MECHANISMS

The "Regulatory Bridge"

The most significant barriers to trade and investment between the EU and the United States are regulations. In many cases, protectionist regulations. This does not mean that their removal is any the easier, in fact the reverse.

National regulations respond to national political priorities, and are adopted according to democratic legislative procedures. Their objectives reveal the way that society is understood, and the way it works, including the role it gives to the individual and government. They also reflect the historical change and experience, the situation of each country and even its way of looking at the future. Obviously, differences which occur in this field will be difficult to resolve, since they are deeply rooted in each country"s regulatory style or approach.

The case of conflicts is once more particularly useful as an example, since it allows us to distinguish between traditional ones, such as customs or trade defence measures, and the new regulatory kind of conflict, which is much more complex and difficult to resolve, as it derives from domestic legislation adopted democratically and in politically sensitive areas (the use of GMOs, breeding livestock using hormones, etc.).

This initial observation obviously means that we have to highlight the essential role played by political will and political support. Without them the success of any initiative to bring the regulatory framework in the EU and the

US closer together is not possible. Politics cannot ignore the different levels of government in which regulatory decisions are taken, since barriers are found at all levels of government. We have to start with a political commitment that there will be action and guaranteed results at all levels. The importance of this aspect has been clearly demonstrated in the development of the different regulatory initiatives initiated since the launch of the New Transatlantic Agenda in 1995.

It is also true that the difficulties in arriving at results in regulatory matters can be overcome when the question under debate is EU-US relations. Despite all the friction, both represent the fundamental nucleus of the Western world. They share values and ways of life to a much greater extent than other regions do with them. Their life choices are inevitably close to each other, since they have grown from shared roots. Regulatory progress must be possible in this case, with the appropriate political impulse.

What rules? The object of the "Regulatory Bridge".

In our discussion of regulatory barriers we will be referring only to those which are not discriminatory. Such barriers are regulations established by governments to achieve specific legitimate objectives, such as guaranteeing the quality of certain products (some technical regulations) or services (such as the regulations governing university certifications), or the stability of the financial system. Their aim is not to discriminate for reasons of the origin of the product or service, but to ensure that certain legitimate ends of governments are achieved.

However, the fact that they may be legitimate and do not discriminate according to the origin of the product or the nationality of the supplier of the service does not mean that they do not obstruct, at times unnecessarily, the traffic of economic operators. It is obviously not the aim of the regulatory bridge to take away from national regulators their ability to guarantee certain objectives which society has delegated to them to regulate. The point is that the national regulators should continue to guarantee these objectives, but in a way that does not create unnecessary obstacles for economic traffic, looking for ways which safeguard the regulatory objectives, but facilitate the way operators work, and thus the flows of trade and investment.

The *Guidelines on Regulatory Cooperation and Transparency*, the *Road Map* and the cooperation projects under way are positive steps, but they are insufficient.

This means hard work on regulatory convergence and mutual recognition of standards ("approved once, accepted everywhere in the transatlantic market"), on the development and adoption of global standards, as well as reinforced political dialogue, including the appropriate institutions through which it can be materialized. It means looking at the details of transatlantic business transactions: how EU and US businesses interact; how the EU and the US economies are intertwined, and how they occasionally clash. We will elaborate on these issues below.

What rules? The pillars of the "Regulatory Bridge" in the APA

The difficulties involved in eliminating regulatory barriers means that the problem has to be approached from all angles. Naturally, the starting point should be an inventory of the barriers, and action with the appropriate instrument according to the sector and the nature of the barrier. We shall now briefly consider the range of instruments proposed by the APA, in what will be the pillars of a "Regulatory Bridge" between the European Union and the United States[13].

Two approaches can be distinguished in the regulatory bridge. One is used to ensure that future regulations do not involve unnecessary barriers, and the other to reduce or eliminate barriers derived from existing regulations.

1. How can we ensure a *future regulatory system* which is favourable to transatlantic prosperity? We believe this can be achieved through:
    - The creation of a permanent mechanism of dialogue between lawmakers.
    - The creation of a permanent mechanism of dialogue between regulators.

[13] Some have argued in favour of "something like a Regulatory Partnership Initiative" in order to remove regulatory barriers. Cfr. Peterson *et. al.* (2005), op. cit.

- Studies on the impact of domestic legislation on bilateral trade, and the notification of new legislative initiatives.
- Exchange of information and consultation.
- The joint development of regulatory principles (general and sectoral).
- Other early warning systems.
- Reinforced cooperation in international negotiations and a search for consensus in international fora such as the OECD.

2. What measures can we introduce to *lessen or eliminate* the hindrance caused by *existing legislation*?
   - Dialogue between lawmakers.
   - Dialogue between regulators.
   - Consultation and exchange of information.
   - Negotiation of mutual recognition agreements, in particular in terms of international standards.
   - Application of common regulatory principles in legislation.
   - Harmonization, but only as an instrument of last resort.

The APA initiative recommends a flexible approach based on mutual trust. Mutual recognition of regulations with a statement of equivalence of legislation might be the best approach to some issues (corporate governance; security controls; services) whereas a stronger commitment to regulatory convergence, with public administrations and independent regulatory bodies instructed to work together towards common goals and the development or adoption of international standards, might be preferable on others (international accounting standards).

Regulatory convergence

In most industries, regulatory harmonization between the EU and the US under the EU single-market approach is not realistic. The APA advocates accelerated approximation of the US and EU regulatory frameworks and reinforced transatlantic regulatory coordination.

There is widespread belief that fundamental differences exist between the European and American approaches to issues such as consumer protection and food safety, so that regulatory convergence between the European Union and the United States is likely to remain a medium or long-term prospect. We believe that this belief is mistaken. We do not think that either EU or US citizens are any more sensitive to health questions. So there must be grounds for an agreement.

The accelerated alignment of regulatory policy measures can take two forms.

1) E*x ante* convergence. This can be successfully applied in areas where regulatory policies and frameworks remain in an early phase of development, such as data and privacy protection on the Internet.

2) Ex post convergence. In sectors that are already highly regulated, like financial services or pharmaceuticals, approximation can be achieved through *ex-post* convergence measures by mutual recognition of each other"s standards and regulatory requirements. A further improvement of transatlantic coordination and consultation mechanisms that draw involvement from regulators and legislators on both sides will be necessary to manage these differences more effectively. The existing institutional structure of the early warning mechanism provides an important foundation in this area that needs to be further strengthened.

Should the EU and the US have divergent approaches, dialogue mechanisms involving early consultation and involvement of the parties concerned should be implemented as a matter of course.

The "enforcers" of regulatory cooperation

As Peterson *et al.* (2005) argue, the EU and US should appoint high-profile "regulatory Cooperation Enforcers", as personal representatives of top political leaders. They should work so as to remove barriers resulting from regulation, but also to ensure that trade disputes do not poison the transatlantic economic relationship by creating genuinely operational systems for early warning of potential future disputes.

Re-designing the Transatlantic Legislative Dialogue

There is a wide consensus on this issue. The legislative dialogue is the weakest link in the NTA framework. The existing Transatlantic Legislators Dialogue (TLD) does not work and should be redesigned. New attempts need to be made to involve legislators more directly in US/EU exchanges. New programmes for exchange between legislative staffers should be launched. A small structure for TLD could be created. Legislative summits could be held prior to annual US/EU summits.

Areas which the "Regulatory Bridge" of the TPA should deal with

The principle has to be that no area should be excluded from the link we are trying to construct. Obviously, the identification of barriers should not be limited to a mere list. There should also be recommendations on the priorities for action. These priorities should be set out in an action plan.

All sectors should be covered, including all trade and investment in all the sectors of goods and services.

Special attention should obviously be paid to the regulatory framework affecting foreign investment

Cooperation on intellectual property should not be forgotten. This is an area in which there have been conflicts between the EU and the US (such as over Havana Club, or the recent conflict over geographical indicators and trade marks). However, common interest is obviously by far the most important element, as would be expected given the economic structure of both regions.

Market access and discriminatory barriers: access to the "Regulatory Bridge"

The obstacles between the EU and the US which operators have to overcome are, as has been pointed out, fundamentally the result of regulations. We consider that these kinds of obstacles are by definition non-discriminatory. However, independently of advances in regulatory matters, traditional barriers may continue to exist, although their importance is

relatively minor. Examples of such barriers which make access to markets difficult are customs, or other discriminatory barriers such as those which demand nationality or residency or limit foreign participation in a company"s equity.

These discriminatory barriers can annul or reduce the advances achieved in regulatory matters. For example, if a mutual recognition agreement is reached in certification for a particular occupation, but the demand for nationality or residency is maintained for people who want to offer the service in question, the usefulness of the regulatory advance is considerably reduced. A similar result occurs if there is an agreement on the application of sanitary and phytosanitary regulations, or the recognition of technical rules for determined products, but customs quotas or barriers are maintained for these products.

To ensure the efficacy of the Regulatory Bridge in the APA, it would has to be complemented by a commitment to reduce or eliminate discriminatory obstacles such as tariffs, quotas, limitations on company equity holdings, residency and nationality demands, etc. Such obstacles could annul or lessen the effect of any regulatory advances which may be achieved.

The APA proposes the elimination of discriminatory barriers which annul or lessen the effectiveness of advances in regulation, not only between the EU and the US, but also between both regions and third countries. In other words, *the elimination of discriminatory barriers will be carried out in accordance with the most-favoured-nation principle*. In the APA, there will be a special and privileged relationship between the EU and US, but it will be non-preferential.

In goods trade, the most important barriers between regions are in the agricultural sector. It is a complex sector which is difficult to deal with politically. It is important to deal with it, apart from its relative size in the economies of the EU and US, and its impact on living standards, because progress in this field would undoubtedly have the virtue of making clear both parties" commitment to advance towards a greater integration and closeness in all fields.

In considering tariff protection, we should remember that although tariffs have been falling as a form of protection, trade defence mechanisms (anti-dumping rights, compensatory or anti-subsidy rights, safeguards) have taken their place, and represent a significant proportion of the cost of protection. Because of this, a good way of reducing trade barriers would be to ban the use of these mechanisms on a bilateral basis. This would also be politically visible, and would tie in naturally with reinforced cooperation which the APA also proposes in the matter of competition. The same could be said of subsidies and other public support, and not only in the agricultural field.

To underline the importance of progress on this question, it is worth remembering the conflict resulting from the imposition by the United States of safeguards in the steel sector, or of that resulting from the public support for both Boeing and Airbus, which the EU and the US are now trying to resolve.

What the APA is not

The APA is an initiative aimed at helping trade and investment flows between the EU and the US, by reducing and/or eliminating the obstacles which the economic operators have to face at present in the traffic between the two regions. It does not propose the creation of a free exchange zone.

As is well known, Article XXIV of the General Agreement on Tariffs and Trade (GATT) allows an exception in applying the most-favoured-nation clause in the cases when a free trade zone or customs union is set up. Article V of the General Agreement on Trade in Services (GATS) allows the same exception for trade in services.

In theory, nothing could stop the EU and the US from following the path offered by the GATT and GATS and setting up a transatlantic free trade area for both goods and services. However, the proposals we are putting forward in this paper do not consist in the creation of a two-dimensional free trade area in goods and services. The APA does not have to ensure its compatibility with WTO rules through article XXIV of the GATT and

Article V of GATS, which deal with regional agreements for economic integration[14].

A traditional initiative to create a free trade zone for goods and services would be capable of eliminating some of the existing barriers between the European and American economies, such as tariffs, quotas and other non-traditional barriers. However, among the most damaging barriers for the transatlantic economy are, as we have seen in Chapter 3, those which arise from different regulations in areas such as consumer protection, national security and data protection, and those derived from different standards. A free trade area would not deal be able to deal with these kinds of barriers.

Moreover, a free trade area would probably lead to trade diversion.

And we should add, as we have seen, that the APA rejects the idea of creating new barriers against third parties. This is incompatible with the creation of a free trade area between the EU and the US if a certain degree of trade diversion was a result.

The creation of a free trade area would be insufficient, since it would not be capable of eliminating very important obstacles to the transatlantic economy, and it would be contrary to the principle of not establishing new barriers against third parties. So the European Trade Commissioner was right when he stated a few months ago: "The aim is not a transatlantic free trade area." Moreover, there is little support on either side of the Atlantic for the idea of a transatlantic free trade area. Many share the view that any such preferential trade agreement between the EU and the US would prove detrimental to their shared long-term interests in global tariff reductions and trade liberalization.

The proposal to create the APA therefore goes further, since it aims to dismantle all the barriers in the transatlantic economy, including those which would not disappear in a free trade area for goods and services.

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[14] See James Mathis (2003), "*Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement*", T-M-C Asser Press, The Hague, The Netherlands.

The APA proposes progress in regulatory matters, compatible with any WTO rules which may be applicable (for example, Article 6 of the TBT Agreement, or Article VII of the GATS, on mutual recognition agreements).

The elimination of discriminatory barriers, whether in the form of tariffs or otherwise, would be carried out according to the principle of the most-favoured-nation status, in other words for all parties. No country would be excluded or be faced with a new barrier as a result of the APA. Thus it is fully compatible with WTO rules, and uses an open-ended mechanism, which we think is the most appropriate for maximising welfare both in the EU and US, as well as around the world.

It also confirms the commitment of the EU and the US to multilateralism, and with the success of the present round of negotiations in the WTO, with the Doha Development Agenda. The APA would be perfectly complementary to any progress in opening-up and liberalization which are now underway in the Development Round. In other words, the APA is a "building block".

The APA aims to reinforce the institutional framework for economic relations between the EU and the US by strengthening the existing framework which of the *New Transatlantic Agenda* and the *Transatlantic Economic Partnership*. A high-level non-permanent committee made up of experts from the business, academic and political worlds will have to be set up as part of the institutional mechanism to identify existing barriers, draw up an inventory and put them in order of priority under an action plan.

The APA does not mean rejecting the institutional mechanisms which already exist. It also does not mean abandoning the initiatives which are already underway, which to a large extent are regulatory in character. It would be a case of taking them on board, revitalizing them, and adding to them any extras considered necessary, taking advantage of the new political impulse provided by the APA.

In this way, the following would be integrated into the APA: the agreements on mutual recognition of technical regulations; the Road Map for regulatory cooperation; the dialogue on financial markets; the action plan on food safety; the negotiations for an open skies agreement; and the agreement on wines.

In addition to this, the various transatlantic dialogues should be given a particularly high profile, in particular the TransAtlantic Business Dialogue. These dialogues can play a fundamental role in the high-level committee which should draw up the APA action plan.

The APA will thus become consolidated as a mechanism for revitalizing economic confidence and as a clear sign of mutual commitment to the shared values of economic opening-up and cooperation between the EU and US in the current international scenario. It would also have the advantage of greater visibility. This would play an essential role in showing European and American citizens the closeness of the two regions.

An open club: an opt-in right for third countries

The APA should be an open club. Any country could join, with the only requirement that it pledges to comply with the rules, and has the necessary institutional capacity to do so effectively. These entry conditions, accepted by the EU and the US, should be public, transparent and non-discriminatory.

We thus suggest a sort of novel application of the Most Favoured Nation clause. Third countries joining the APA would enjoy the same benefits as the EU and the US.

This way, inefficiencies resulting from trade diversion could be avoided. In addition, there would be no ground for political criticism, which would certainly take place if the APA were to become a "closed club just for the rich".

Already existing free trade agreements of the US and the EU with third countries should be opened to the partner on the other shore of the Atlantic; these countries would be offered automatically a full opting-in possibility in the APA.

Some states should automatically be given the right to join, since they are obviously capable of complying with the established rules should they join.

Political dialogue

Strengthening the institutional structures for political dialogue between policymakers in the European Union and United States is essential for the

transatlantic economy. Consultations and exchanges serve to lay the ground for improved cooperation. As US Under-Secretary of Commerce for International Trade Grant Aldonas has argued, "cooperation, consensus and concrete action cannot simply materialize out of thin air"[15]. They must be underpinned by political dialogue at all levels.

Building on the success of the informal Financial Markets Regulatory Dialogue, similar more formalized fora for dialogue between regulators on both sides of the Atlantic could be established in other areas to assist the process towards the APA. These would provide the basis for regular exchanges on regulatory approaches and best practices and also function as fora for discussions on the technical process of implementing regulatory convergence and cooperation to achieve the APA.

The APA must be built:

- Using the current institutional framework supporting transatlantic relations;
- In the European case, from the Community dimension;
- With the full support and implication of the private sector;
- Incorporating early-warning mechanisms able to detect potential conflicts and deactivate them;
- Incorporating EU and US coordination mechanisms in multilateral fora

THE PRINCIPLES OF THE APA

The APA model based on *mutual recognition of regulation*, *regulatory convergence*, *mutual recognition of standards*, *adoption of global standards* and *reinforced political and legislative dialogue* would provide a powerful model for regulatory policy cooperation that third countries could aspire to emulate. At the same time, it would provide the United States and the

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[15] Cfr. Grant Aldonas (2003), "*A new transatlantic economic dynamic*", speech at the Transatlantic Centre, German Marshall Fund, Brussels, November 24 2003.

Available at w*ww.uspolicy.be/Categories/Trade/Nov2403AldonasGMF.html*

European Union with a basis for transatlantic leadership on market liberalization and regulatory cooperation within multilateral institutions.

To fulfil this mission, the Atlantic Prosperity Area would be based on the following principles:

- *A specific* and *privileged* but *non-discriminatory EU-US relationship.*
- *A "standstill clause",* making it impossible to create any trade or financial obstacle between the EU and the US once the APA agreement is in force.
- *A "sunset clause",* establishing clear and defined timetables for eliminating barriers in the transatlantic economy.
- *A "rendezvous" clause,* defining the regular meetings to be held by the various regulatory cooperation fora, ranging from the highest level of annual summits to the lower levels.
- *"Safe harbour" agreements.* These are a practical way of making systems inter-operable without either side abandoning its essential principles. The APA does not require the harmonization of EU or US laws or regulatory approaches, but it would lead to de facto harmonization by regulatory agencies and firms. Safe-harbour agreements offer positive lessons for other areas.
- *Transparency.*

THE IMPLEMENTATION OF THE APA

Ensuring an effective enforcement of the APA agreements

The agreement for the creation of the APA should incorporate an important extra point: a guarantee for the application of the sectoral agreements reached both in the EU and the US, irrespectively of how the jurisdiction of the various political and administrative levels is distributed (federal administration-states and EU-member states-regional authorities).

The agreement should resolve once and for all the problem posed by the fact that certain competences correspond to the federated states or federal regulatory agencies in the case of the US, and member states or regional authorities in the case of certain EU members.

Ensuring effective implementation of the APA agreements

First of all, the project of creating an Atlantic Prosperity Area should be embodied in a formal agreement. A new formal partnership agreement between the United States and the European Union, and not just its member states, is needed to secure the Atlantic relationship and manage its development cooperatively, to encourage greater involvement by the political communities on both sides of the Atlantic.

Under the NTA and the TEP, numerous areas of cooperation have been agreed with mixed results. When planning a new initiative, lessons should be learned from the failures and best practices derived from the successes.

This APA agreement should include:

— *A specific timetable for the removal of barriers and the implementation of the Atlantic Prosperity Area.*

We believe that the APA should be launched together with the TPN[16] no later than 2007 with the objective of the APA being fully implemented by 2016. The June 2006 Summit could discuss the idea, consult with each party concerned over the next twelve months and then approve the APA Agreement at the 2007 EU-US Summit.

We suggest the following calendar:

- June 2007 Transatlantic Summit: adoption of the core and the framework of the new Atlantic initiative.
- December 2007: adoption of the action plans.
- June 2008 Transatlantic Summit: first assessment of the results achieved.

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[16] The TPN, in its *Strategy to Strengthen Transatlantic Partnership* currently envisages a general target date of 2010 for the completion of a Transatlantic Market and an accelerated target date of 2010 for four areas: financial services and capital markets, civil aviation, the digital economy (privacy, security and intellectual property rights) and competition policy. Cfr. Transatlantic Policy Network (2003), "*A Strategy to Strengthen Transatlantic Partnership*", Washington/Brussels, p. 23, available at *www.tpnonline.org*

— *Area-specific actions and stages and clear respective target dates for completion against which progress could be measured at a mid-term stage*

Area-specific dialogues between regulators and new consultation mechanisms between both sides need to be implemented. The APA initiative should include specific objectives, timetables and review mechanisms to assess progress regularly and where necessary to make adjustments taking account of changes in the overall environment.

— *A road map outlining the course of action for the implementation of the APA*

— *An institutional structure for political supervision*

The annual summit meetings between the United States, the European Commission and the governments of the EU member states should be established as the core institutional structure overseeing the process of implementing the APA. Within this framework, the EU and US leaders could provide the political supervision and initiative needed to steer the creation of the APA. This institutional structure could also serve as an important forum for high-level discussions in areas where negotiations on regulatory convergence or cooperation at administrative levels have reached a gridlock. It should furthermore set out a broad framework for transatlantic political dialogue and cooperation on matters related to the APA. Every annual EU-US summit should be committed to:

- monitoring to ensure that timetables and targets are met;
- ensuring the continuous improvement of the APA project.

— *Feedback mechanisms on proposed regulatory changes to be introduced by regulatory agencies, business and other interested parties*[17]

With extensive stakeholder participation, each annual meeting should monitor progress towards the long-term goal of a 100% barrier-free

[17] Cfr. Transatlantic Policy Network (2003), "*A Strategy to Strengthen Transatlantic Partnership*", Washington/Brussels, p. 23, available at *www.tpnonline.org*

transatlantic market, defining responsibilities, allocating tasks and setting new objectives. Reports on the implementation of the initiative would be submitted to each summit.

ADDING TO THE "SPAGHETTI BOWL" OR UNTANGLING THE "SPAGHETTI"?

The APA should lead to a simplification of the complex set of trade agreements that both the EU and the US currently hold. The APA is not "another trade agreement" adding to the "spaguetti bowl" but a way of untangling the "spaguetti".

As a result of the APA, current EU and US free trade agreements would gradually merge into the APA following the novel form of MFN clause.

All EU and US Economic Partnership Agreements with ACPs and non-ACPs would be put together, consolidating all the preferential trade agreements of the US and the EU with their favoured LDCs into a single mutually open arrangement.

THE APA IS A "BUILDING BLOCK", NOT A "STUMBLING BLOCK"

Bhagwati has highlighted that there are two main concerns regarding the debate on regionalism vs. multilateralism:

1) The "spaghetti bowl" problem, resulting from proliferation of bilateral and regional preferential trade agreements.
2) The "dynamic issue" as to whether preferential trade arrangements are building blocks towards the goal of non-discriminatory multilateral free trade or whether they act as stumbling blocks.

The APA is designed as a WTO-plus, free-trade oriented, building-block agreement. It creates an open club with transparent and non-discriminatory rules for membership dealing with issues to which GATT-GATS/WTO rules do not provide an appropriate answer. The idea is to make the APA rules part of the GATT-GATS/WTO system when the political momentum makes it possible.

REMOVAL OF TRADITIONAL TRADE BARRIERS: TARIFFS

Although, as mentioned before, EU-US tariffs are generally low, averaging between 3%-4% on bilateral trade, tariffs are still high on products in sensitive sectors.

Dismantling tariffs on transatlantic trade continues to be an important goal[18]. Within this process, action on the *tariff peaks* is a priority.

However, tariff reduction would be best achieved within the context of the WTO Doha Round rather than bilaterally. If the EU and US were to decide to eliminate tariffs between them, it could fatally kill this key part of the WTO multilateral negotiation.

The highest tariff barriers to trade between the two regions are in the agricultural industries (average MFN tariff in the EU is 17.3%, 10.6% in the US)[19]. Agricultural reform is extremely important both to the EU and the US. Agriculture is once again a core element of the multilateral trade negotiations and both the EU and the US have an interest in lowering trade barriers. The effects for developing countries of EU and US liberalization of agricultural trade barriers could be substantial. We will deal with this crucial issue later on.

Though the average tariffs on trade in manufactures between the EU and the US are low (the average MFN tariff for the EU is 4.2% and 5% for the US) the high volume of trade guarantees that further reductions in these barriers will still yield significant benefits.

Significant and general tariff reduction and the elimination of tariff peaks on goods must be implemented as a result of the Doha Development Agenda. The results of the Hong Kong meeting in December 2005 are completely insufficient.

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[18] The dismantlement of tariffs in transatlantic trade continues to be an important objective of the TABD.

[19] Centre for Economic Policy Research (2002), "Enhancing Economic Cooperation between the EU and the Americas. An Economic Assessment", London, May.

REMOVAL OF NON-TRADITIONAL TRADE AND INVESTMENT BARRIERS

As stated before, tariffs are not the major obstacle to trade. Contingent protection (antidumping, countervailing duties, safeguard measures, antidumping) and other barriers undermine the achievements of multilateral negotiations. There is no need to insist on the importance of regulatory barriers to trade in goods and services.

An important lesson of the OECD's work is that product market deregulation rather than tariff reductions would provide the main source of economic gain. This finding is not a surprise, as we already know that tariff and non-tariff traditional barriers are rather small, while domestic product market regulations often remain substantial, especially in the service sector.

We have already highlighted that investment flows between the EU and US are large and growing. Efforts need to be made in both the EU and the US to ensure that foreign-owned firms face the same regulatory environment as domestic companies and have access to the same markets. This is particularly important in the service sector. The EU's Single Market Programme provides guidance on how to proceed with liberalizing these sectors, and lessons learnt from this programme could be usefully applied to EU-US relations.

Initially, action is needed at the multilateral level, within the Doha Development Agenda Round. In this respect, Hong Kong has produced extremely deceiving results. Besides the much needed efforts in service liberalization of developing nations, both the EU and the US must implement improved offers on services.

However, most of the barriers can be tackled bilaterally. A bilateral understanding between the US and the EU on quantitative forms of protection could form the cornerstone of a global agreement limiting the unilateral use of these trade restrictions.

The priority must be to tackle the regulatory barriers, which have become the most important barriers for transatlantic business. The TABD objective is a good one: *"Approved once, accepted everywhere in the transatlantic market".* The Regulatory Bridge should provide the proper instruments.

Required for freeing transatlantic services: liberalization within the EU. The Bolkestein Directive

We have already stated that barriers to trade in services remain on both sides of the Atlantic. The main hurdles are in sectors such as maritime, legal, accounting and architectural services[20].

However, the core of the problem remains in the EU. It is quite obvious that it makes little sense to talk about transatlantic integration when national markets within the EU are still segmented. As Hamilton and Quinlan conclude, liberalization of services within the EU would be the single most important stimulus to the transatlantic services economy. Given the deep integration of the transatlantic economy, it would certainly produce mutual gains for both the United States and Europe.

— *Increased transatlantic FDI flows.* The removal of barriers to service activities in the EU would attract more FDI from US companies.

— *Greater cross-border trade in services.*

— *Raising productivity and growth; lower costs and prices*. Service liberalization would trigger higher cross-border competition in services. Productivity would rise and costs would decline, this leading to lower prices for services. Services being an essential input of many manufacturing industries, Europe"s manufacturing sector would also benefit from service liberalization. Rising productivity would be a real shot in the arm for the EU economy, and liberalization would boost economic growth.

— *New jobs and higher wages.* Higher productivity would result in higher employment and higher real wages.

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[20] Cfr. Findley, C. and Warren, T. (Eds) (2000), *"Impediments to Trade in Services:Measurement and Policy Implications",* London: Routledge; Kalirajan, K. (2000), "Restrictions on Trade in Distributive Services", Productivity Commission Staff Research Paper, Canberra: AusInfo, August; Nguyen-Hongh, D. (2000), "Restrictions on Trade in Professional Services", Productivity Commission Staff Research Paper, Canberra: AusInfo, August; Buck, T. (2005), "OECD stresses services market reform benefits", *Financial Times*, April 27; Copenhagen Economics (2005), *"Economic Assessment of the Barriers to the Internal Market for Services",* Copenhagen, January.

As a result of the 1988 Single Act, the EU Single Market ensuring free movement of goods, services, people and capital was supposed to be fully implemented on January 1, 1993.

At the 2000 Lisbon Summit, and with the leadership of British Prime Minister Tony Blair and Spanish Prime Minister José María Aznar, EU leaders announced the 2010 Lisbon Agenda, a ambitious mid-term liberalization and modernization strategy aimed at removing all types of remaining barriers within the EU and implementing the knowledge society, so as to make the EU "the most dynamic and competitive knowledge-based economy in the world by 2010".

Lack of liberalization impetus among governments in some of the EU core countries means that five years later we unfortunately see markets for services continue to be segmented, hampered by 15+10 different sets of national regulations.

Through the so-called Bolkenstein Directive (also referred to as the Services Directive)[21], the European Commission intends to remove all pending service barriers with a *horizontal approach*, i.e. setting "a legal framework that will eliminate the obstacles to the freedom of establishment for service providers and the free movement of services between the Member States"[22].

The Bolkenstein Directive proposes the right approach to liberalization, based on the widely applied "country of origin" principle, granting companies the right to provide services in all EU member states as long as they fulfil the laws of their county of origin. This principle is, for example, at the core of the Single Market for banking services, as supervisory rules are the ones of the home state, once some minimum solvency standards are agreed and implemented.

Unfortunately, some protectionist European politicians have argued that this Directive may cause "social dumping".

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[21] European Commission, "Directive of the European Parliament and of the Council on Services in the Internal Market", Proposal, COM(2004) 2 final/3, March 5, 2004. Cfr. Buck, T. (2005), "A recipe for jobs or a race to the bottom? The EU debates a single market in services", *Financial Times*, March 15; AmCham EU submission to the US-EU Stakeholder"s Dialogue (2004), December 6.

[22] Cfr. Gros, D. (2005), "Europe needs the single market in services", *Financial Times*, April 7.

PROPOSALS TO REMOVE HORIZONTAL BARRIERS

Forgetting safeguard provisions against alleged serious injury to domestic industry

The EU and US should agree to eliminate the reciprocal use of the safeguard clause in mutual trade relations, regardless of the affected party and any possible causes which could result in a drastic increase in EU imports from the US or vice versa.

In other words, the safeguard clause would disappear completely from the list of instruments for "trade defence" (trade protection would provide a more accurate picture) in the Atlantic relationship.

Renouncing anti-dumping policies

Dumping is an empty concept and is another name for unwelcome competition. It would help relations across the Atlantic immensely if anti-dumping were expunged from the trade vocabulary of the US and EU. We propose a complete new approach to anti-dumping policies. Appropriate EU-US cooperation in the field of antitrust or competition policy could easily lead to the disappearance of current antidumping policies.

Anti-dumping policies should be completely reconsidered and reviewed under transatlantic competition or antitrust policies. If authorities consider there are well-based economic foundations to act against anti-competitive behaviour, the proper tool is competition policy. Obviously, non-discriminatory rules and procedures should be enforced[23].

In the short term, the US Congress should repeal the *Byrd Amendment*, as President Bush has proposed[24].

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[23] See Daniel Ikenson (2005), "*Abuse of Discretion. Time to fix the Administration of the U.S. Antidumping Law"*, CATO Institute, October 6.

[24] Mariko Sachanta, "Japan weighs anti-US duties", *Financial Times* 29 July 2005, pg. 10.

Foregoing public subsidies

The EU and US should establish a definitive timetable for the gradual elimination of all the subsidies which distort international trade, starting with agricultural subsidies. Export subsidies to agricultural goods are supposed to be banned multilaterally by 2013 as a result of the WTO meeting in Hong Kong. 2010 would have been better.

In the case of the airline industry, there should be a timetable for phasing out the public aid, including both aid offered by the EU, the countries forming the EADS-Airbus consortium, and the other governments to Airbus, and the aid which the US and other governments offer to Boeing.

PUBLIC SUBSIDIES: THE BOEING-AIRBUS CASE

Recently some economists have argued in favour of a transatlantic integration of Airbus and Boeing operations as a way of eliminating frictions and a way of cooperating in future projects in an effective way and avoiding a trade war between both companies. Thus Hamilton y Quinlan (2005)[25].

This view is highly dangerous, as it would mean creating a *de facto* single world manufacturer and a global monopoly. The idea of merging the two companies to form a single global commercial-aircraft manufacturer should be rejected. Despite the political temptation of having exclusive decision-making capacity over the supply of elements so essential to any country as aircraft, the creation of a monopoly would not only be the source of distortions in the transatlantic market, but would also generate justifiable protest in the rest of the world.

The aviation industry has advanced most when competition has acted as the main driving force for research and development into making more efficient jets. This technical progress has been possible thanks to a whole chain of research in fields such as mechanics, materials and fuels. Without the pressure to compete it is very likely that this progress would be jeopardized.

[25] Cfr. Richard Aboulafia (2005), *"Commercial Aerospace and the Transatlantic Economy"*, in Hamilton and Quinlan, op. cit.

Our proposal is not to merge activities under so-called transatlantic cooperation in the aviation industry. What we stand for is the defence of fair competition in which existing barriers are removed, and efficiency, technical advances and best practices are rewarded by a global market.

In other words, we are against subsidies being poured into Boeing and Airbus. The WTO has already resolved trade disputes between the EU and the US. Indeed, subsidies will be a dispute that both parties will have to face[26], and even though the dispute settlement mechanism is slow, it will force the companies and governments involved to adopt its resolutions and to undertake the path of reaching common agreements as under Air Traffic Control Association (ATCA).

It would be in the interest of both parties to agree to a transparent code in which financial aid could only be granted from governments under specific circumstances, and to avoid interference from domestic authorities. The full implementation of ATCA is still pending, but more necessary than ever.

With regard to the political influence on aircraft purchases, it is impossible to ask State-owned airlines not to follow government directives, but it is certainly not justifiable to blackmail trade agreements under using possible aircraft purchases. It is negative both for the final customers and for the industry as a whole to be led by political factors rather than efficiency-driven ones. Creating a joint commission to analyse these issues has been a first step in this direction, although not sufficient.

By-passing WTO procedures for public subsidies, dumping, and serious injury

The creation of an Atlantic Prosperity Area requires a drastic dismantling of the whole practice of public subsidy, but it also means that alleged dumping and serious injury have to be rejected.

We need agreements banning government subsidies, especially export subsidies, and giving up all appeals to “dumping” and “serious injury” and the

[26] See *The Wall Street Journal,* “WTO Creates Panels to Investigate EU and U.S. Airplane Subsidies”, July 21, 2005.

corresponding demands for anti-dumping measures and serious injury redress. No serious scientific arguments support a government role in promoting economic growth, nor are there any arguments suggesting that dumping and the sudden inflow of imports are evils which have to be contained. The political consequences of interventions against free trade are grave because they foster conflict among trading nations. It is obvious from experience and even from the very description of the procedure set up by the WTO that attempts must be made to get rid of those barriers.

The growth of special interests around those partial measures, favouring small groups at the expense of the general public and the prosperity of society as a whole, make it very difficult for these non-traditional obstacles to be dispensed with. That is why the future of the transatlantic prosperity area depends on the slate of intervention being wiped clean.

An area free of export subsidies, anti-dumping and serious-injury redressing measures, open to other nations willing to clear the path to their prosperity, could help create a prosperity zone in the North Atlantic and be an important step in the direction of world free trade.

Protection by anti-trust

Despite some well-known high-profile conflicts, US and EU authorities have worked efficiently to minimize conflicts resulting from different laws and policies through a cooperative model that could potentially spread to other fields of public policy[27].

The substantive divergences indicated in the section on the identification of barriers have in some cases allowed the identification of what is or should be possible in harmonizing the two systems, although for historical, cultural and economic reasons they will never be the same. In terms of the procedure used, it is easy to see the result of confronting the American system of conflict resolution, which is highly legalized, and the European, in

[27] According to the *Financial Times*, "The growth of US-EU cooperation on antitrust policy shows different methods can co-exist, provided objectives are broadly shared – or at least understood – and agencies do not retreat into territorial defensiveness."

which the administrative bodies play a very significant role. In practice, the US and the EU have accepted the need to strengthen and speed up the development of their relations in order to minimize the risk of future transatlantic conflicts and maximize the degree of convergence in their respective competition policies.

When deciding on possible measures to increase the degree of convergence in this respect, the various types conduct under analysis has to be distinguished. They include concentrations, unilateral conduct and cartels.

Mergers.

As indicated above, the anti-competitive effects of a merger are not as clear as in the case of cartels[28]. A merger can increase the power of the market, but it can also create greater efficiency and reduce prices to consumers. This is why its effects have to be carefully analysed and the European Union and United States have developed a structure called the *Merger Guidelines* as a framework for both jurisdictions in the revision of mergers. This structure defines the parameters of the market in question and allows an analysis of the unilateral effects of company combination and its possible anti-competitive measures. The most important factor in this respect is to centralize the analysis exclusively in competition and not take into account other factors such as consumer protection.

From a theoretical point of view, this kind of analysis is similar in both jurisdictions, although it is not identical. The common starting point is a definition of the markets in question. Once the markets have been defined, the effects on them of the merger can be studied.

The *US guidelines* emphasize the levels of concentration in the market in question after the merger, and measure these levels using the Herfindahl-Hirschman Index (HHI). However, these conclusions depend on a series of other factors which are also included in the guidelines, such as the

[28] Cfr. Hewitt Pate, op.cit.

characteristics of the market and the possibility that new companies could begin to operate in it[29].

In the *EU system*, until recently the analysis was based on evaluating whether the operation resulted in the creation or reinforcement of a dominant position which constituted an obstacle for effective competition in the market. This evaluation took into account the same factors, such as the level of concentration, the characteristics of the market and the possibility of new competitors entering the market. However, the level of concentration was not used as a benchmark, although occasionally the HHI index was mentioned in market analysis.

After the disagreements resulting from the GE/Honeywell case, the European Union has clarified its position stating that it shares the criterion that the ultimate objective of competition policy should be the good of the consumer. It admitted that mergers could generate efficiency, and that concentration should not be questioned simply because it allowed a company to achieve a high market share.[30] The GE/Honeywell case has highlighted the value for officials on both sides of the Atlantic of cooperation in this kind of case, and the need for a wide-ranging discussion in various parallel fora. This gives a new dynamism to the relationship. Thus on the one hand convergence in the merger revision process was increased by the conclusion of the EU's Merger Review Process[31].

After severely criticizing the strict revision standard known as the "dominance test", it adopts a wider and more flexible substantive method of analysis. This means that the concept of a dominant market position has lost importance when it comes to reviewing mergers, and the regulations cover all mergers which significantly impede competition. They thus draw closer to the

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[29] The HHI index is calculated by summing the squares of the market share of each of the operators. Other tools used include cross-elasticity studies, critical loss analysis and merger simulation techniques.

[30] Cfr. William Kolasky, (2002), "Internacional Convergence Efforts. A US Perspective", Internacional Competition Law Conference, Toronto, 22 March.

[31] EU Merger Guidelines.

Available at http://europa.eu.int/comm/competition/mergers/legislation/regulation/best_practices.pdf

American "lessening of competition" test. This convergence should contribute to the reduction of transaction costs associated with certain merger processes[32].

On the question of procedure, the exchange of good practice across the Atlantic in cooperation and investigation of mergers is another form of contributing towards convergence. It is clear that increasing cooperation substantially reduces the risk of intervening in different or incoherent ways in the same operation.

In addition, the efforts of both agencies have been channelled through two important discussion fora:

- The *US/EU Merger Working Group*: created to analyse mergers, the efficiencies generated, solutions which could be applied, and the procedures and time-frames to apply.
- The *International Competition Network (ICN):* this was launched by the governments of the main jurisdictions in the struggle against monopolistic practices to develop guidelines on good practices for competition bodies.

These fora could potentially significantly improve the quality of the enforcement of competition law in a wide range of areas, especially (but not only) in the assessment of mergers.

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[32] In addition, the new European guidelines on mergers establish the following criteria for evaluation: *a*) *Market share and concentration levels* (special attention should be paid to the synergies which could result from mergers, and it should not simply be assumed that the combined quota of the merging parties will be equal to the sum of their previous market shares); *b) Possible anti-competitive effects c) Countervailing buyer power*; *d) Entry of new competitors; e) Efficiencies* directly benefitting consumers and which should be substantial, verifiable and a direct consequence of the merger. (The necessary information to demonstrate the existence of these efficiencies should be provided by the notifying parties in due time) *f) Failing firm exception:* If one of the merging parties is a failing firm this operation will not be considered to create or reinforce a dominant position if the notifying parties demonstrate that the following requirements are met: 1) that the allegedly failing firm would by forced out of the market not taken over; 2) that there is no less anti-competitive alternative purchase; and 3) that the assets of the failing firm would inevitably exit the market in the absence of a merger.

Unilateral company conduct

It is in the area of unilateral behaviour by companies where there are greatest divergences and misunderstandings between the competition authorities on both sides of the Atlantic. It is not only very important to determine if a competitor is competing aggressively or in an anti-competitive fashion, but it presents serious problems and calls for the application of objective and transparent standards with a solid basis in economics.

The courts have generally accepted the explicit application of a standard that is not based only on the European Union concept of a dominant position (the significant impediment to effective competition). In this way the analysis has less legal inflexibility and a sounder basis in economics, and the role and scope of the concept of efficiency has been changed, while at the same time the costs of transaction have been reduced[33].

It has to be stressed that it is important that anti-monopoly legislation should allow even dominant companies to compete aggressively. It is still not clear to what extent the EU shares this view. In addition, setting up practices which make unilateral anti-competitive conduct more difficult requires at least as much diligence as that required once a violation has been found. The formula for creating disincentives to this kind of conduct also needs a greater convergence in the policies of the EU and US.

Cartels

This is the field where the need to adopt not only corrective policies but also preventive ones is most apparent. The sanctions for violating

[33] However, the most conservative experts believe that the new European law extends the scope of cases which can lead to the stopping of a merger or acquisition, since it establishes that the Commission can deny authorization for a merger "if it represents a significant obstacle for effective competition", regardless of whether or not there is a position of dominance. They consider this an advantage in that it allows the ample present jurisprudence on the creation or reinforcement of a position of dominance to remain in place, and any possible effect of concentrations which may not be included under the concept of position of dominance to be covered as well. In this way there is a risk that the application of the new regulation does not create more flexibility than before, but quite the reverse, by including more of the reasons for blocking the concentration. See "EU & Competition", January 2004, available at http://www.simmons-simmons.com/docs/ec-law-reform-dec03-english.pdf.

competition principles should be severe, as their aim is to counteract the significant benefits gained by participants in a cartel at the expense of consumers.

In accordance with this principle, the United States has been applying a number of mechanisms such as the following: 1) increasing the fines which are imposed in the criminal justice system on companies which violate competition laws; 2) applying severe sanctions on the directors responsible for companies involved in these agreements (these sanctions can even include restrictions on movement abroad); and 3) tripling the amount awarded to victims of the economic damage caused by the cartel (with the plaintiffs freed of liability to damages).

In parallel, an amnesty programme was also developed. This is a series of incentives to encourage cooperation with investigations, and includes the following measures: 1) immunity for the first company involved in the cartel which offers to cooperate with the authorities; 2) exceptions for directors in certain circumstances (avoiding prison and reductions in fines); and 3) limiting damage payments.

The European Union has developed a similar system, and regularly imposes significant fines on companies which form cartels. In 2002 the European Union revised its immunity programme and adapted it to ensure a greater convergence. This is extremely relevant in areas related to legal security for people participating in these programmes by collaborating with the authorities.

These kinds of policies aim to give the competition authorities the tools needed to discover and prosecute cartels. However, they also have another important benefit. They serve to prevent and/or destabilize cartels by revealing the illegal activity. Given that cartels act without borders in a globalized world, the more extensive these kinds of policies are, the more effective their application and enforcement. Global enforcement would offer greater mechanisms to dissuade and impede the formation of cartels. Since international efforts are required to fight cartels, work in fora such as the ICN Cartel Working Group formed in 2004 gives an added boost to bilateral efforts.

Other reconcilable institutional differences: the process of European modernization

Some of the criticisms of the European system such as the fact the different assessment system, the centralization, the involvement of the justice system, etc. have received a specific treatment in the modernization process initiated by the Union. For example, on 1 March 2004 the new Regulation CE 1/2003 came into force. It includes reforms on questions such as legal security, decentralization in applying competition rules, simplification of administrative procedures and transparency in the decision-making processes.

Among the most important objectives included in the reform are:

1. Giving powers to the national authorities to apply European competition law;
2. Promoting private legal actions in national courts;
3. Freeing Commission resources so that it can concentrate its attention on the big cartels;
4. Increasing the investigative power of the Commission.

One of the main new points in the Regulation in this respect is the suppression of the centralized notification and authorization system established by Article 81(3) of the EU Treaty, according to which an agreement which has effects contrary to competition can be considered legitimate as long at it produces sufficient compensatory benefits for consumers. This article can now be invoked directly by companies before a court or national competition authority without any declaration to the Commission. The agreement, decision or conduct in question should be considered legal if the party can demonstrate that it complies with the conditions established in the paragraph in question.[34].

[34] Companies will be able to decide for themselves if the agreements infringe the prohibition or not. However, there is also the risk of adopting mistaken decisions, so that the protection which existed before against fines through notifications of agreements disappears.

In addition, according to the new system, the administrative competition authorities and the courts of the member states will apply Articles 81 and 82 of the European Community Treaty directly. Thus some of the significant differences in the system on both sides of the Atlantic in terms of the assessment mechanisms (legal in the US and administrative in the EU) are no longer so great as before. It is true that the administrative system has a positive element in terms of the speed of its procedures, but it is clear that in terms of reducing divergences between the two systems, the best route was to implement this kind of assessment process.

The European Union aims to create a system allowing the national competition authorities and the national courts to fully apply the European competition law, although the Commission continues to have the option of dealing with cases which are important for the EU. Among the measures adopted are the following:

- A network of national competition authorities (NCAs) has been set up, known as the European Competition Network (ECN). It will help ensure that cases are handled efficiently, enforcement is consistent across the EU, and double jeopardy is avoided.
- Information exchange procedures between the ANC have been set up.
- Although each NCA has the same power to apply Articles 81 and 82 of the EC Treaty,[35] the Commission retains the power to take over a case, even though an NCA has begun acting.
- The new general policy of the Commission encourages third parties to present suits before the national competition authorities.
- National courts will be able to decide for themselves whether an agreement fulfils the criteria for exemption (cases will not be suspended just because one of the parties has notified the agreement in dispute to the Commission). The Regulation also contains provisions for the Commission and the NCAs to intervene in national court cases. The probable increase in private enforcement means that the question of which jurisdiction is most appropriate for initiating proceedings (taking into account such factors as the availability of damages or interim measures and investigative powers of the court) will be increasingly important in the new regime.

Despite the progress on convergence which some of these measures represent, it has been pointed out that the enforcement of European competition law by the NCAs may involve the risk of an interpretation which is not coherent with the laws, of inconsistent procedures and duplicity of controls. This in turn could create problems when it comes to increasing coordination with the competition authorities of the United States and third countries. This is why the Commission and the Member states will have to significantly increase their efforts to ensure that the decentralization in applying the laws operates in a satisfactory manner.

In addition, the legal framework by which the Commission applies the European competition laws has been reoriented to emphasize the powers of investigation, allowing searches in private premises, and increased enforcement of information request and fines. The changes related to the complaints procedure suggest that oral hearings will be more contradictory (a greater participation by the parties involved, and a greater capacity to question during the proceedings, etc.) In addition, Regulation 139/2004 extends the investigative powers of the Commission, which can demand all the information necessary, and interview all the persons who may have useful information, as long as they agree to such an interview. Lastly, the criticism of the structure of the investigative teams has been at least partially resolved through the designation of a chief economist in the General Directorate of Competition in the European Commission, and the creation of a group of economists to evaluate company concentrations. This helps ensure that competition policy has a sound economic base.

Intense cooperation does not necessarily mean that the parties agree on all questions. Even in the same legal system, as in the United States, there may be differences between federal and state organs. These differences can be even greater in a confederal structure such as that now in place in the European Union. However, the existence of superimposed jurisdictional structures in the area of competition may lead to significant problems, which will become increasingly severe as the process of economic internationalization grows. The analysis above leads to the conclusion that in the case of the European Union and the United States, although there are still significant differences, collaboration between conflict resolution bodies and convergence between the two systems is not only recommendable, but also possible.

The regulatory mess

Given the differences in approach and the structure of regulation, a series of mechanisms have been established to treat regulatory questions affecting the EU and the US.

Within the framework of the *New Transatlantic Agenda*, the Transatlantic Business Dialogue and the Transatlantic Consumer Dialogue actively contribute to cooperation, by designing joint recommendations for the authorities.

Meanwhile, another series of initiatives related to cooperation on regulatory questions stems from the Mutual Recognition Agreements which eliminate double assessments and certifications in six sectors: telecommunications equipment, pharmaceutical products, medical equipment, electromagnetic compatibility, electrical safety and recreational products. The agreements were signed in June 1997, although they did not come into force until December 1998. These attempts to solve differences through mutual recognition agreements centred on the recognition of assessments carried out in each jurisdiction and in guidelines for the exchange of information between agencies, have contributed to a certain extent to the growth of the transatlantic economy, but they are far from being completely satisfactory.

In April 2002, the United States and the European Union completed the long-running negotiations on a series of *Guidelines on Regulatory Cooperation and Transparency*. Their aim was to reduce trade conflicts caused by regulatory questions. The main elements of the guidelines are as follows: 1) To improve the quality of the planning of regulatory proposals and reduce divergence in regulations through increased cooperation between regulators; 2) To obtain an increased predictability in the development and establishment of regulations guaranteeing exchange of information for this end; 3) To grant the opportunity for regulators to provide their partners in other countries with recommendations; 4) To promote public participation and confidence in regulatory policy by offering comprehensible information on the adoption of technical regulations and offering a greater and more generalized public access to important documents; 5) To exchange information on knowledge,

especially in terms of the alternative approaches and unintended negative effects.

Later, in the June 2004 summit, both parties created the *Road Map for US-EU Regulatory Cooperation and Transparency*, which outlined a series of cooperation activities in the area of regulation, and explicitly specified the decision-making process in the case of pharmaceutical products, cosmetics, chemicals, etc.

In addition to these formal negotiations, the regulators have created a series of informal initiatives to reinforce transatlantic cooperation. Examples of this kind of cooperation are the agreements between agencies to share non-public information on the principle that more information leads to better regulation. It is true that this kind of agreement does not create any kind of international obligation, but it does allow the parties to be warned of certain problems which could otherwise occur.

However, these activities and guidelines do not appear to have solved the problems arising from the different interpretations of questions such as those mentioned relating to the precautionary principle. In this respect, the Commission stated in a Communication of February 2000 that the precautionary principle could be invoked when potentially dangerous effects of a phenomenon, product or procedure have been identified through an objective scientific evaluation, even though this evaluation could not establish the risk with a sufficient degree of certainty. This is the source of divergence, since the United States does not apply this principle, so that total regulatory convergence in this sense could only be achieved if the parties reached an agreement to apply or eliminate it.

The bilateral trade system between the European Union and the United States should at the same time guarantee the freedom to trade and the desire of countries to maintain high health and environmental safety standards. Without going to the extreme of total inclusion or elimination, a restricted but shared application of the precautionary principle by both parties could be studied. The principle should only be invoked in the case of a potential risk and under certain agreed conditions, but in no case should it justify arbitrary decision.

Recourse to the precautionary principle should be guided by three specific guidelines:

- It should base its application on the most complete scientific evaluation possible: this evaluation should be able to determine the degree of scientific uncertainty at each stage.
- Every decision taken under the principle should be preceded by an analysis of the risks and potential consequences of not taking any action. The action to be taken will depend on a political decision according to what is considered an acceptable level of risk by the society which is subject to the risk. This will need convergence between Europe and the United States.
- As soon as results from the scientific and/or risk evaluation are available, all the interested parties should be able to participate in the study of the different possible actions. The procedure should be as transparent as possible.

In addition to these specific principles, general principles of good risk management are also applicable when the precautionary principle is invoked. These general principles are:

- Proportionality between the measures adopted and the level of protection chosen.
- No discrimination in the application of the measures;
- Coherence of the measures with others which have been adopted before in similar situations or using similar approaches;
- Analysis of the advantages and disadvantages from action or lack of action.
- Revision of the measures in the light of new scientific knowledge.

It may be concluded from the above that the solution to divergence can only be found through dialogue and close cooperation between regulators. To avoid divergent decisions on the same case some of the essential objectives of this cooperation should be:

- Greater transparency in regulatory processes.

- Ensuring that both interested parties can make commentaries on the legal processes sufficiently early for their observations to be of use.
- Developing strategies which can help prevent regulatory discrepancies before they occur or to resolve disputes once they have arisen.
- Encouraging the interested parties on both sides of the Atlantic to hold regular meetings and discuss relevant questions
- Information sharing between agencies and a commitment to regular technical exchanges and greater dialogue between working groups.

For example, a good strategy could be to share regulatory initiatives between agencies with similar objectives, in order to consider the impact of a law on the actors on both sides of the Atlantic. However, we have to bear in mind that each regulatory agency has its own responsibilities and specific missions. It may also not have a big enough budget to coordinate actions with its foreign counterparts and given the great diversity of political structures few regulatory agencies have mandates which fit perfectly with the missions of other agencies. This is another point to consider when specifying actions in the negotiation process. It would also be useful to compare regulatory policy directives in those areas in which laws have not yet been passed or in which the technologies involved have really been transformed. Thus the most relevant needs are:

- Political understanding on both sides of the Atlantic in order to find viable solutions to difficult problems.
- Early and permanent communication.
- Incorporating non-governmental agents.
- Giving the regulator the tools and budget needed to do his work as well as possible.

An alternative vision of the problem could be an emphasis not so much on convergence through negotiation as on recognition of the competence of regulations. This procedure would have the advantage of offering quicker and more efficient solutions, and prevent the need for permanent negotiations which would have to be continually reopened in economies undergoing a rapid technological development.

To a certain extent, this strategy would mean applying to transatlantic relations the same principles that the European Union ended up using for mutual recognition of regulations in its own member states, after years of attempts to harmonize the regulations on all products. It would be a dead end. Of course, the problem is based on knowing whether there is a real chance or not of reaching an agreement of this kind.

If there was, and it was thought that this approach was the best, then the main objective of the European Union and the United States should be to focus negotiations on the achievement of this kind of agreement. But if it was thought that the chance of reaching it was minimal, a second-best solution would be to continue with negotiations for greater convergence on regulatory questions and suggest concrete improvements such as those outlined above, in order to establish more efficient coordination procedures for the regulations in place today, and for those which have to be introduced in the future.

EXAMPLES AND PROPOSALS IN THE FIELD OF REGULATORY COOPERATION.

Regulatory cooperation is not only a way of settling disputes, but also of facilitating trade and investment by removing key non-tariff barriers. To be successful, regulatory cooperation must deal with such delicate issues as law and national sovereignty, the independence of regulators, different levels of power, and different legal and administrative procedures.

Wide-ranging regulatory cooperation between the EU and the US is at the core of the Positive Economic Agenda. Regulatory cooperation must be complemented with dialogue-based dispute settlement management mechanisms.

The EU-US *Guidelines for Regulatory Cooperation and Transparency* outline a broad range of activities intended to expand market opportunities and help minimize EU-US regulatory divergence. Regulatory cooperation can take place in all its aspects, from equivalence to mutual recognition. Implementation of the Guidelines has yielded good progress in a number of regulatory areas, but the scope for potential EU-US cooperation is far broader.

The EU and the US need to understand that major changes are needed in the current approach to sovereign prerogatives and legislative mandates of agencies on each side of the Atlantic in order to accommodate the needs of an efficient, seamless transatlantic market.

Moreover, the European Commission and the US Administration must continue with their current regulatory cooperation projects, but may also advance by identifying additional specific cooperative projects, as well as horizontal initiatives and potential improvements to the scope and operation of the Guidelines. Clarification of the role of the Guidelines as a policy tool for EU and US regulators would also help them define their approaches for promoting effective regulatory cooperation.

Consequently, effective implementation and improvement of the EU-US Guidelines for Regulatory Cooperation and Transparency must be a top priority.

Positive sectoral regulatory cooperation has already been implemented in certain industries, but it can be expanded.

- *Pharmaceuticals*[36]

  The regulatory cooperation group on pharmaceuticals should expand the exchange of information and data on pharmaceuticals as agreed under the September 2003 arrangement between FDA, DG Enterprise and the European Agency for the Evaluation of Medicinal Products (EMEA). Further measures as part of this arrangement should include: cooperation on parallel scientific advice; promotion of scientific staff exchanges and joint meetings; sharing of respective draft guidance on drug safety issues, including adverse reactions; and examination of cases where EU and US authorities have adopted different approval decisions for specific drugs (benchmarking exercises).

[35] This means that companies and their advisors will need a better knowledge of the requirements of competition law and national court proceedings in each of the member states in which they may be legally responsible through their agreements or conduct. The questions relative to the most appropriate jurisdiction for presenting a suit or applying a clemency programme will be more important in the future.

- *Auto Safety*[37]

  The regulatory cooperation group on Auto Safety should develop agreed work plans for the specific regulatory projects to be pursued under the NUTS-DG Enterprise regulatory dialogue created under the June 2003 exchange of letters.

- *Information and Communications Technology Standards*[38]

  The regulatory cooperation group on Information and Communications Technology Standards should pursue specific projects under the EU-US dialogue initiated in March 2004 and coordinated by the Commerce Department and DG Enterprise, including e-accessibility, security, and biometrics.

- *Cosmetics*[39]

  The regulatory cooperation group on Cosmetics should pursue regulatory cooperation activities as outlined in the agreed 2003 project work plan. Possible new areas for cooperation as part of the Cosmetics Harmonization and International Cooperation (CHIC) process should be identified.

- *Consumer Product Safety*[40]

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[36] The current group pursues regulatory cooperation between the US Food and Drug Administration (FDA), DG Enterprise/Pharmaceuticals Unit and the European Agency for the Evaluation of Medicinal Products (EMEA) on matters related to ensuring the safety, quality and efficacy of pharmaceutical products.

[37] The current group pursues regulatory cooperation between the US National Highway Traffic Safety Administration (NHTSA) and DG Enterprise/Automobile Unit in areas of auto safety regulations.

[38] The current group is working to identify and pursue information exchange on the use of information and communication technology (ICT) standards in support of regulations.

[39] The current group is pursuing regulatory cooperation between the US Food and Drug Administration (FDA) and DG Enterprise/Cosmetics Unit regarding: a) alternative (i.e. non-animal) testing methods; b) respective regulatory approaches applied in the area of hair dyes; and c) other projects of mutual interest.

[40] The current group is pursuing regulatory cooperation between the US Consumer Product Safety Commission (CPSC) and DG SANCO regarding safety notices and corrective actions of hazardous consumer products.

The regulatory cooperation group on Consumer Product Safety should make progress in order to reach an arrangement between CPSC and DG SANCO to facilitate the sharing of data/information from the RAPEX System.[41]

- *Nutritional Labelling*[42]

  The regulatory cooperation group on Nutritional Labelling can make additional progress in comparing the scope of nutritional labelling requirements in the EU and US as well as in the identification of specific activities for cooperation on technical issues such as reference values for nutrient labelling, nutrient definitions, and energy conversion factors.

The TEP (APA, if the initiative is implemented) Steering Group should give a new impetus to the following groups:

- *FDA-DG SANCO Regulatory Dialogue*[43]
- *Regulatory Dialogues between the European Commission (EC) and the US Government involving European Regulatory Agencies*[44]
- *CPSC-DG SANCO Regulatory Dialogue*[45]

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[41] RAPEX serves as a single rapid alert system for dangerous consumer products in Europe. All non-food products intended for consumers, or likely under reasonably foreseeable conditions to be used by consumers, are included within the scope of RAPEX, with the exception of pharmaceutical products.

[42] The current group is pursuing regulatory cooperation between the FDA and DG SANCO on issues of mutual interest in the field of nutritional labeling.

[43] The current group is working to establish a broad new FDA-SANCO regulatory dialogue and to identify specific regulatory cooperation projects of mutual interest.

[44] The current group is pursuing improved regulatory cooperation in the following areas: a) regulatory dialogue between FDA, the European Commission, and the European Food Safety Authority (EFSA); b) enhanced ongoing regulatory cooperation between the European Commission and FDA and the European Agency for the Evaluation of Medicinal Products (EMEA); c) an exploration of possible new or enhanced regulatory dialogues in areas of mutual interest between the European Commission and the US Government involving, where appropriate, other European Regulatory Agencies.

[45] The current group intends to establish a regulatory dialogue between CPSC and DG SANCO regarding the EU"s revised General Product Safety Directive.

- *Eco-Design*[46]

The TEP (APA) Steering Group should also engage in new regulatory discussions, like those dealing with chemicals[47].

The new group on chemicals should continue informal discussions, where appropriate, on issues of mutual interest both through bilateral exchanges and in the margins of other meetings, such as the OECD.

Within the APA agreement, the TEP (APA) Steering Group must also make progress in *horizontal initiatives on regulatory cooperation*. A specific Horizontal Group could concentrate its efforts on the following issues:

- *General Regulatory Policy.*

  The Horizontal Group should explore a regular informal dialogue between the relevant authorities of the European Commission and the US Government on regulatory policy issues and practices of mutual interest. Examples should include practices and procedures in regulatory processes, tools, transparency and public consultation and impact assessment methodologies. This dialogue should try to ensure that new regulation is produced collaboratively and transparently, with attention to cost-benefit analysis and assessment of the transatlantic impacts.

- *Regulatory Work plans.*

  The Horizontal Group should establish a mechanism for regular exchange and discussion of annual US and EC regulatory work plans. Such a review could help identify additional prospective areas for EU-US regulatory cooperation.

- *US-EC Regulatory Exchanges.*

  The Horizontal Group should identify resources and mechanisms to

[46] The current group is exploring possible cooperation between the US Environmental Protection Agency (EPA) and DGs Energy and Transport, Environment and Enterprise in the area of eco-design of energy-using products.

[47] The current group is developing informal discussions, in the spirit of the Guidelines, between the US Environmental Protection Agency (EPA), DGs Environment and Enterprise and relevant agencies on chemicals related issues of mutual interest.

promote exchanges of US and EC regulatory experts in specific areas/projects of mutual interest.

- *US-EC Regulatory Seminar/Workshops.*

  The Horizontal Group should conduct seminars/workshops where EU and EC regulators can exchange views and raise awareness of our respective regulatory activities, priorities and approaches on issues of mutual interest.

- *Outreach Activities.*

The Horizontal Group should identify and pursue approaches to promote:

1) broader visibility/awareness within the USG, EC and among transatlantic stakeholders of the Guidelines;

2) the importance of EU-US regulatory cooperation;

3) opportunities for stakeholders to propose regulatory cooperation activities under the Guidelines.

Within the APA agreement, the TEP (APA) Steering Group should consider an eventual expansion of the scope of the Guidelines to:

- more directly address standards-related matters.

- address other regulatory activities not currently covered.

The TEP Steering Group should also develop a model confidentiality agreement that could be adapted, as appropriate, to the sharing of confidential information under a range of EU-US regulatory cooperation projects. A model agreement, based on the existing FDA-DG Enterprise confidentiality agreement for sharing information on pharmaceuticals, could be formally referenced in the Guidelines or be added as an annex to the Guidelines.

A final task for the TEP Steering Group would be to identify potential improvements to the Guidelines that could further enhance its effectiveness and its role as a mechanism intended to support a broad range of EU-US regulatory cooperation in areas of mutual interest.

CONSUMER PROTECTION

Some pundits insist on "different sensitivities" to consumer protection in the US and the EU, and thus in different approaches of regulators and legislators when it comes to consumer protection regulation.

But, it is reasonable to think that US citizens are less concerned about their health than Europeans? Because that would be the logical conclusion of the supporters of Europe"s rejection of some products which are, on the contrary, accessible to American consumers. Let us take the example of tobacco. US regulation is much more stringent than Europe"s average. Different sensitivities and thus asymmetric regulation does not seem to be a reasonable outcome for the transatlantic economy.

Trade in the expanding sector of *organic food products* can be enhanced.

The recent agreement on *wine* trade, based on mutual recognition (in this case, of oenological practices), is the right way to move forward.

"Labelling" seems to be the most practical way to solve many disputes, following the example provided by the "safe harbour" agreement. Labelling respects consumer rights to be informed as well as a sufficient protection resulting from regulation is ensured.

Public procurement

Though buy-America policies and difficulties linked to sub-federal rights in procurement suggest there is little room for optimism, this area is so fundamental to fair international competition that it simply cannot be avoided.

Moreover, any EU-US agreement in this area must ensure that it does not jeopardize current negotiations in the GPA or WIPO.

Apart from direct barriers, the complexity of the regulations relating to public procurement can effectively act as an indirect barrier. Normally, suppliers from GPA signatory countries are not directly excluded by the scope of the restrictive "*Buy American*" *Act*, which generally allows exceptions for these suppliers. However, the implementation of these kinds of exceptions

can produce a considerable degree of legal uncertainty. Thus many of the problems experienced by European suppliers in winning public tenders in America could be solved by increasing the areas covered by the GPA, clarifying the regulations and their application, and eliminating some exceptions introduced by the United States. In addition to other initiatives, a revision of the GPA would offer a good opportunity to improve the present situation.

As well as this, while the United States denies abusing exceptions for national security, it would be interesting to know to what extent the country is disposed to give clear guidelines to identify purchases covered by the agreement and those covered by the exception within the context of the GPA. There would have to be a definition of the kind of supplies necessary for national security, and more coherence between the federal system for classifying tenders and the harmonized international system. These steps would indicate a significant advance towards more acceptable practices.

In questions of national security there is today a tendency in the US Defence Department to adopt other less discriminatory choices than those based on the buy-American clause. In line with this new trend, the preference for a particular producer of goods or service provider is no longer exclusively guided by buy-American restrictions. Instead, it is subject to a qualification awarded to the country which maintains reciprocal Memoranda of Understanding (MoU) with the United States. Qualified countries receive higher preferences. However, despite the fact that in 2004, 11 EU Member states were in the position of qualified countries, the European Union continues to be concerned about the practical application of the provisions of the MoU. This is because the MoU are subject to US laws and regulations, so that new restrictions could be imposed any year by Congress.

At the same time, any new sub-federal laws as in the case of the Massachusetts and Myanmar (Burma) could contribute to an increase in tensions between the European Union and the United States. On this point it is critical for the American lawmakers and officials to take note of the declaration of unconstitutionality handed down by the Supreme Court. Although the declaration was unanimous, it was only based on the system of

division of powers (supremacy clause)[48], and has given rise to numerous interpretations in terms of future sanctions that could be taken in cases of procurement by sub-federal states. In fact, in addition to Massachusetts, a variety of states (California, Connecticut, New York, Texas, etc.) proposed similar laws extending their interests abroad, although they later withdrew them.

Among the measures which could be adopted to prevent and resolve conflicts of this kind are the following: [49]

- An increase in the degree to which state lawmakers and governors respect constitutional restrictions when they draw up and vote on legislation (or when they sign it in the case of governors). This needs a consensus on the interpretations, and the jurisprudence laid down by the courts has to be applied. These considerations could even be incorporated even to the training of public officials.
- In the same way, a legal analysis should be used to evaluate the conformity of sub-federal laws with the international trade agreements, including those of the WTO.
- Officials should be made more aware of constitutional commitments and restrictions arising from international agreements and the effect on their actions. It is important for the federal government to train its officials and to reinforce its collaboration with the different state

[48] Essentially, the US Supreme Court said that the states should not become involved in foreign policy. It maintianed that the Massachussets law on Myanmar (Burman) undermined the aims and natural effects of at least three clauses of the federal law: a) the discretionary powers of the President to impose economic sanctions on Myanmar (in this case the federal sanctions were limited to new investments by US companies; b) application of limited sanctions to American persons and new investments; c) the guidelines for the President to procede diplomatically on the development of a multilateral strategy with respect to Myanmar. Thus sanctions by the federal government on Myanmar have priority over the Massachusetts law insofar as "The state Act is at odds with the president"s intended authority to speak for the United States among the world"s nations in developing a comprehensive, multilateral strategy to bring democracy to and improve human rights practices and the quality of life in Burma". (Judge David H. Souter writing for the court).

[49] See Matthew Schaeffer, "*Lessons From The Dispute Over The Massachussets Act Regulating State Contracts with Companies Doing Business with Burma (Myanmar)*", Robert Schuman Centre for Advanced Studies, European Universitary Institute.

administrations, along the line in which it has been working with consultations on other matters between the states and federal administration.

- It has also been suggested that it could be beneficial as a preventive measure for sub-federal officials to take part in relevant EU-US summits and/or transatlantic dialogues (such as the Business Dialogue).
- A continuous active monitoring by the business sector could contribute to prevent the implementation of policies which could potentially cause international tension.
- On the question of conflict resolution, the WTO way may not be suitable, since there are various requirements that have to be met for the GPA regulations to be applicable to US states. In the WTO, even if the complaint is successful, the problem would be resolved only if the state affected decided to amend its conduct, or if the federal government demanded compliance. In order to reduce costs, the European Union, as an affected party, should assess whether a constitutional appeal would be more effective or not, although it is true that if the same case is before the WTO this could be used as an argument in a claim before the courts.
- Having chosen the route of internal reclamation, the presentation of amicus curiae reports by the interested parties opposing the law in question can become extremely important when the court decides on its judgement (especially if the federal government is included).

In disputes affecting cases of public procurement at a state or local level, it has been said that those disputes resulting from laws whose main objective is the protection of companies in the area (such as the buy-local laws) have less chance of being resolved in favour of the competition in conflicts taken to the WTO (at least in the foreseeable future) than disputes motivated by extra-territorial legislation (such as the Massachusetts law discussed above). The reason is that on the question of protection for local enterprises, no state or sub-federal body has given its agreement to be limited in a way requiring a change or liberalization in its legal system.

Essentially, EU negotiations on the subject of local protectionism are more or less paralysed, and today there are only 37 states committed to the GPA in

contracts for goods and services to the value of more than half a million dollars. The other 13 states maintain their full powers to establish new protectionist legislation. Thus the existence of limited agreements with states and a lack of commitment by many of them can mean that disputes based on non-federal non-compliance with the GPA of the buy-local sort are rarely presented.

In addition, suits filed in American courts related to clauses such as the buy-American or buy-in-state would not have too much chance of success. This kind of protectionist law for sub-federal state procurement appears to have survived all previous legal challenges. Thus the preferential treatment given to local suppliers will continue to cause friction in international negotiations while the European Union tries to obtain a greater coverage for sub-federal cases. It seems that the best alternative for cases in which a state applies protectionist measures is still the WTO dispute resolution body, as long as the contracts are covered by the GPA.

In terms of other kinds of policies for which protection measures are used in public procurement systems, as is the case of the promotion of small businesses, an analysis should be carried out of the possibility of establishing alternative measures which do not result in discrimination against foreign suppliers.

Finally, we still have to wait before a final assessment can be made of the possible impact of the new European Directive which, as mentioned above, has not yet entered into force.

Court decisions

Given the globalization of trade and investment, the liberalization of the sale of goods and the provision of cross-border services, combined with increasing use of electronic media in international transactions, it has become more urgent than ever to find a solution to the problems caused by foreign court judgements, which are causing numerous difficulties related to duplication of resources, excessive time and greater costs for the parties involved.

Apart from the differences over jurisdiction, in the United States the recognition by state courts of final and binding decisions of courts in other

states is not as complete as in the case of the EU, nor are they applied automatically. Thus the Brussels I Regulation (and indeed the ideas behind the Brussels Convention itself) represents an important advance, especially considering that the court decisions in Europe have an international and not only inter-state character, and that the member states do not share common legal systems or even common languages. This is why it is encouraging that the United States continues to engage in negotiations to achieve positive results in the Hague Conference on Private International law. Unfortunately, so far the perspectives for the multilateral treaty it is negotiating are not promising.

There are a number of existing problems. On the one hand, the American states and the federal courts recognize the decisions of foreign countries with sufficient generosity to reduce the incentives of other nations to negotiate with the United States. On the other hand, because of its confusing nature the legislation now in force increases obstacles for this kind of agreement. What is more, the fact that the Supreme Court has given the subject of jurisdiction a quasi-constitutional hierarchy complicates the situation of the American negotiators to a large extent. If it were possible to make a clean slate and start again, the best way to ensure mutual recognition and enforcement of American and European judgements would surely be for the United States to negotiate with the European Union as the EFTA countries did to such good effect in the Lugano Convention.

Climate change policies

Neither the EU nor the US on its own can solve the global climate-change challenge. Important emitters of greenhouse gases such as China and India are not in the Kyoto Protocol.

It is clear that the climate change challenge can only be effectively addressed on the condition that *all* emitters, including all industrialized countries and at least the major emitters among developing countries, participate in an emissions-reduction system. If the highest authorities finally decided to implement an Atlantic emissions-reduction system, the scheme should be constructed upon a non-negotiable principle: the implementation of a global system of emissions trading.

As a result of the Montreal Summit, there are some encouraging developments. There will be a post-Kyoto system, and the US has agreed to participate in it. That is good news. Only with the full participation of all major emitters (the US, the EU, Japan, other OECD countries, China, India and other fast-growing developing countries) can climate change objectives be achieved.

An Atlantic agreement in this field would be helpful to the future global agreement on global climate change policies. Several options to reach an Atlantic climate change agreement have been developed[50].

CO-OPERATION IN NUCLEAR ENERGY. THE ITER PROJECT

In the context of the debate on climate change and the need to reduce greenhouse-gas emissions, there are different opinions as to whether or not the "2050 goals" can be achieved with technically proven technology.

Some scientists argue that current technologies could solve the climate problem for the next fifty years[51], while others believe that new and revolutionary technologies will be needed[52]. Is nuclear fusion the real breakthrough technology (though not yet technically proven) to solve this problem after 2050?

The International Thermonuclear Experimental Reactor (ITER) is an international scientific and technological project of extraordinary importance, and only exceeded in size by the International Space Station. After demonstrating the scientific viability of producing energy through

[50] Cfr. Egenhofer, C. "*Climate Change: Could a transatlantic greenhouse gas emissions market work?*", in Hamilton and Quinlan (2005), op.cit. As a result of the 2005 EU-US Summit, see "*Energy Security, Energy Efficiency, Renewables and Economic Development*", available at http://www.europa.eu.int

[51] Cfr. Pacala, S. and Socolow, R. (2004), "Stabilization Wedges: Solving the Climate Problem for the Next 50 Years with Current Technologies", *Science*, Vol. 305, August 13, 2004, pp. 968-972; IPPC (2001), *Third Assessment Report*, summary for policy-makers, Intergovernmental Panel on Climate Change, United Nations, 2001.

[52] Cfr. Hoffert, M.I. et al. (2002), "Advanced Technology Paths to Global Climate Stability: Energy for a Greenhouse Planet", *Science*, Vol. 298, November 1.

nuclear fusion[53], the next step is to construct an experimental reactor which demonstrates the technological viability of producing electrical energy using nuclear fusion. It is not a commercial project, but a scientific and technological research of the first order. The challenge consists in producing 500 megawatts of energy in periods of 500 seconds.

The ITER project was started in the 1980s as an ambitious and expensive major international project to develop and construct an experimental nuclear fusion reactor to produce energy. It has gradually taken the form it has now, and the ITER consortium includes the EU, US, Japan, Canada, Russia and South Korea.

Nuclear fusion is a potentially large-scale energy resource which could be extremely useful in covering the future increase in energy needs worldwide. The advantages are numerous, because it is a source of energy with the following characteristics:

— It is inexhaustible: its main fuel deuterium is present in the hydrogen in the sea. Tritium also does not present any problems of shortages.

— It is safe: it does not have any of the risks associated with nuclear energy because there is no chain reaction involved.

— It is very powerful: only 25 grams of reactive fuel produce enough energy for one person in a developed country to use in a lifetime.

— It is environmentally acceptable: it generates easily-managed low-level radioactive waste.

After nine years of work by an international team of about a hundred scientists and engineers, the design was completed in 2001. The total budget for the project is about 10 billion euros. About half of this is for the construction of ITER over a period of 10 years (2005-2010). The rest is for the running of the plant for about a further 20 years. The scientists consider that the project will need about 30 years in all.

After completing the design, the next step was to choose the site and to begin construction. A number of options were rejected before the EU

[53] So far energy has been produced by nuclear fusion in two different machines: the Joint European Torus JET in Oxfordshire (run by the European Union), and the Toroidal Fusion Thermonuclear Reactor TFRT in Princeton.

agreed on Cadarache in France as the site of the reactor itself, and Vandellós in Spain as the headquarters of the body which will run the project. Japan also participates with a headquarters at Rokkasho Mura.

Both the EU and the US have a severe structural problem in energy supply, which may well become worse in the next few decades.

The US plays an essential role in the project because of its scientific and technological resources.

Standards

Different standards are the source of substantial trade barriers across the Atlantic. Action is needed on this question.

Mutual recognition of standards is the appropriate solution in many goods and services markets. Mutual recognition must be the first-best choice whenever possible.

In this sense, the "safe harbour" agreement provided us with a practical way of making systems interoperable without either the US or the EU abandoning their main principles.

In other cases, harmonization is either the optimal solution for efficiency reasons, or simply the only possible solution - for example, when standards are simply incompatible for technical reasons.

Technical criteria should be the only ones applied to make the choice for harmonized standards.

CASE STUDY: MOBILE TELECOMMUNICATIONS STANDARDS

For 3G mobile telecommunication platforms, the European Commission chose the UMTS standard; in the US, CDMA-2000 and UMTS will compete. China, as explained before, is implementing a third standard, the TD-SCDMA.

Both the EU top-down and the US bottom-up approaches to standardization have advantages and drawbacks.

The US market-driven approach seems to generate a better outcome in choosing the best performing standard, though market segmentation translates into slower market growth.

On the other hand, EU markets seem to have benefited from a single standard, taking the lead over US markets. Network economies seem to be a powerful engine for market development.

The specific features of the future 4G platforms are expected to be standardized by the ITU in 2007. Experts argue 4G technologies will lead to inter-technology integration into an open wireless architecture.

If this does not happen, the need to promote further cooperation on the development of common or interoperable standards is obvious.

In this sense, a hybrid approach is suggested. A market-oriented approach could be implemented for a certain period of time. Then, an independent technical group would suggest to the US and EU telecoms authorities which single standard they should adopt for the whole Atlantic community.

Security measures

Security being a higher goal, we propose to minimize distortions through increased cooperation between European and US authorities. The EU and the US must ensure that trade facilitation and security are mutually supportive to avoid hindering legitimate trade.

The least impact possible of national security on trade should be sought in areas such as export controls on dual use goods, customs procedures or trade facilitation. This may mean harmonization in some areas, such as common or international security standards, but mutual recognition is often an easier and more practical way to remove obstacles.

The “Agreement between the European Community and the United States of America on intensifying and broadening the Agreement on customs

cooperation and mutual assistance in customs matters to include cooperation on Container Security and related matters", signed in Washington D.C. in April 2004, is a perfect example on how to achieve progress.

Acquisition of business visas takes too much time and becomes a costly process. The US and the EU should urgently reduce the time and costs of acquiring business visas.

Electronic ID systems with biometric parameters should be implemented both in the US and the EU Member States on a voluntary basis, to reduce the time and costs of acquiring business visas.

In addition, the EU and US could collaborate on developing a single RFID standard that could then be applied at a global level.

A brilliant suggestion of the TABD concerning the implementation of a project to analyse risk and exchange information about shipments between the US, the EU and third countries, must be a top priority, helping both trade and security.

Ongoing cooperation through the High Level Policy Dialogue for Border and Transport and Security (PDBTS) is very positively rated. Pragmatic arrangements have already been agreed.

All these issues related to security and trade could be dealt with in a general chapter on trade facilitation.

Professional services

Removing the current barriers affecting trade in services requires action in several directions:

Mutual recognition of qualifications

Harmonization is neither feasible nor desirable. We advocate market signalling, which can play a valuable and efficient role.

Actions to ensure market access and national treatment

The EU Single Market Programme provides guidance on how to proceed with liberalizing these sectors, and lessons learnt from this programme could be usefully applied to EU-US relations.

However, this is not sufficient, as the Single Market does not yet exist in several markets for professional services. The EU member states should urgently fulfil its often-declared objectives of removing barriers to services.

Electronic commerce

The EU and the US face common problems in areas such as e-commerce, Internet governance, anti-spam legislation and criminal activities through the Internet.

Fraud in e-commerce, spam, the criminal industry of child pornography and criminal practices in the spreading malicious viruses must be urgently tackled.

The policy dialogue must be reinforced. A common regulatory framework should be explored. In any case, mechanisms of for exchanging best practices would be very fruitful.

With regard to criminal activities, police and judicial cooperation must be reinforced.

Intellectual property rights

The EU and US should tackle the scourge of international counterfeiting and piracy, which damages the interests of businesses, consumers and governments[54].

To increase protection for holders of intellectual property rights, the EU and US governments should continue to pursue joint dialogue with third-party

[54] As a result of the 2005 EU-US Summit, see "*EU-US Working Together to Fight Against Global Piracy and Counterfeiting*", available at http://www.europa.eu.int

governments. Raising awareness of the dangers and unacceptability of counterfeiting and piracy and strengthening public awareness to suppress them are essential in fighting this problem.

The US STOP initiative is very welcome. The EU Commission Paper on Intellectual Property enforcement in third countries and EU legislative initiatives already adopted or under discussion to combat the problem at a local level in the critical geographical areas must also be welcome.

The EU and the US must also support the OECD study project related to the economic impacts of counterfeiting.

However, laws establishing new taxes on electronic digital equipment (to compensate for alleged losses of authors" rights) would be a complete mistake, as they would limit the extension of the information society.

There are also difficulties regarding patents. Once more, regulatory cooperation is the answer. Any EU-US agreement should not jeopardize current negotiations in the Government Procurement Agreement (GPA) or the World Intellectual Property Organization (WIPO).

Corporate governance and accounting standards

The APA faces an additional challenge if it wants to achieve a truly integrated economic space. This is the removal of barriers related to corporate governance and accounting standards. As has been argued in chapter 4, a big opportunity could be lost if there is no success with a "transatlantic practice". Moreover, transatlantic economies might begin to suffer serious consequences, such as the de-listing of EU companies on US stocks markets, if nothing is done. As a proposal for the removal of such barriers, the APA promotes several regulatory changes.

The first is related to compliance with Sarbanes-Oxley Act´s (SOxA) internal control standards. It is said by critics that the demands of Section 404 of SOxA imposed unjustified costs and time-consuming transitions on all US-listed EU companies. Some initial steps have been taken. A year-long reprieve for non-US listed companies has been granted until July 15, 2006.

The APA faces a second challenge related to auditing standards. Recent US legislation, particularly the SOxA, represents a shift in the regulations on this question, and has become one of the major points of contention between the US and the EU. This new regulation, according to Hamilton and Quilan[55], "puts significant emphasis on the regulation of not only accounting and auditing practices of a registered public accounting firm, but also that of any Certified Public Accountant (CPA) associated therewith, and any CPA working as an auditor of a publicly traded company". Following ratification of SOxA, the SEC established the Public Company Accounting Oversight Board (PCAOB) as a regulator, ending a period of self-regulation. As the authority of PCAOB extends to non-US accounting firms working for any US-listed company, any European company must be subject to the control of the PCAOB or the SEC, and has, for example, to comply with requests to supply its work papers to them. This has led to discontent in Europe. Furthermore, despite efforts to achieve a mutual recognition of equivalent systems of auditing on both sides of the Atlantic, the SEC remains sceptical of European audit practices, impeding progress in this area.

The third proposal to eliminate barriers in this field relates to the introduction of a single set of global accounting standards. While European policy-makers have expressed their willingness to extend the mutual recognition principle to EU-listed US companies reporting in US Generally Accepted Accounting Principles (GAAP), the SEC has remained reluctant, so far, to accept the International Financial Reporting Standards (IFRS), the system European companies must use, as equivalent to the US GAAP. SEC´s position is explained, partly, by the fact that enforcement of accounting rules in the EU is still national and there is no EU enforcement body. Furthermore, there is no European counterpart to the SEC able to offer equivalence to any foreign accounting system, apart from the corresponding national bodies.

Obviously, there is an urgent need to reach an agreement in this field if we are to achieve a prosperity area between both sides of the Atlantic. However, an effort from EU members to unify their regulators might be necessary first.

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[55] Cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (eds) (2005), "*Deep Integration: HowTransatlantic Markets are Leading Globalization",* Washington, DC and Brussels: Center for Transatlantic Relations and Centre for European Policy Studies.

Nevertheless, the process to build an Atlantic Prosperity Area with regard to this issue has already produced positive results. Since the adoption of IFRS in the EU, the SEC has eased disclosure of historical results by US-listed European companies. Moreover, the SEC and EU policy-makers have recently announced a road map designed to ensure the elimination of the reconciliation requirements for US-listed companies by 2009.

As a fourth proposal, the APA calls for actions to ease the process of deregistration from the SEC for European companies as a result of the high regulatory costs and costly transitions that US listed companies might face if barriers were not dropped. Fortunately, the SEC is examining ways in which such European companies can be exempted from some corporate governance requirements. Our proposal recommends that EU listed companies may opt out of the US measures if the SEC is satisfied that the parallel EU measures are sufficient.

Finally, on the question of introducing new regulatory frameworks, it is important to ask for measures which are sufficiently flexible to accumulate the wide range of firms and corporate law regimes. For the EU, its role should be to ensure a certain level of coordination between member states, and make it possible to provide for minimum standards.

As a result of such proposals, the APA initiative expects there will be more extensive cooperation between the EU and the US, affecting capital mobility, and hence driving product and labour market reforms, leading, in turn, to lowering costs of capital. Additionally, as Hamilton and Quilan state that “the increasing trend toward adoption of similar techniques and institutions, accompanied by extensive interest group pressures, may create additional incentives for directors and managers to adopt internal organizational forms that are more efficient”.

The EU and US should reinforce mutual cooperation so as to recognize equivalent rules on either side of the Atlantic in corporate governance and related matters. Corporate governance policies in the EU and the US should take into account the global environment in which companies move.

Any additional regulations should be properly assessed, and include the effects of new corporate governance regulations on the transatlantic economy.

In the short term, the US and the EU should make a special effort to find a solution to the tension resulting from Section 404 of the Sarbanes-Oxley Act and from the 300-shareholder threshold for EU companies wanting to de-list and to terminate US reporting requirements.

REMOVING VERTICAL BARRIERS SECTOR BY SECTOR

The automotive sector

There are no significant barriers to transatlantic trade in the automotive sector.

A new and sharp cut in tariffs on automotive products is desirable for both the EU and the US as part of the final Doha agreement.

The only regulatory issues that could be highlighted here are the technical specifications that are not harmonized in terms of emissions, power, consumption and safety issues. Regulatory cooperation needs to improve. Mutual recognition (and not necessarily harmonization) could be useful in the area of technical regulations.

Mutual recognition should allow all products –including components, accessories and sub-assemblies such as engines– to be used in both markets. Mutual recognition would allow for immediate vehicle homologation in Europe and North America, and would dramatically reduce indirect costs. This would be extremely important.

Telecommunication services

Enhanced Atlantic cooperation toward further integration has developed in the last few years, starting with the 1998 EU-US Mutual Recognition Agreement (MRA) on communications equipment. Constructive endeavours resulted following the 2004 EU-US summit. The activity of the Information Society Dialogue (ISD) must be assessed positively.

Satellite-based telecommunications services being a great source of opportunities, the July 2004 Agreement on cooperation between the Galileo

and GPS satellite navigation systems opens the way for wide-ranging commercial opportunities.

All this is good news. But, once more, we need major progress, not just small steps forward. The creation of an integrated transatlantic market for telecoms services is still hindered by the existence of restrictions to market openness on both sides of the Atlantic.

Once more, we propose a twin approach to further liberalization of the market for transatlantic telecommunications services: a WTO MFN-based package and a WTO-plus Atlantic agreement aimed at regulatory cooperation, open to the rest of the world. Third countries would be welcome once they commit themselves to fulfilling its terms.

On the Atlantic front, many EU member states must avoid further delays in the implementation of the new telecoms regulatory package.

More importantly, as both the US and the EU are in the process of thoroughly reconsidering their existing regulatory frameworks, we would welcome an Atlantic Telecommunications Regulatory Forum (TRF) enhancing regulatory convergence by developing a Basic Telecommunications Regulatory Framework (BTRF) to be implemented by both the EU and the US.

The BTRF should promote close cooperation when new regulations are to be developed. That would mean, for example, on the European side, fluent exchange of information with the US authorities once the new EU Regulatory Framework on electronic communications begins its implementation stage (in June 2006).

The BTRF should combine the flexible approach to regulation based on a systemic view and on the convergence of sector-specific regulation and competition policy contained in the 2002 EU Regulatory Framework and the market-opening approach of the US legislation.

The BTRF should oblige National Regulatory Authorities of the US, the EU and its member states to base their regulatory decisions in the following principles:

- *Technological neutrality.* Regulatory measures should not discriminate between the same services delivered over different technological platforms.
- *Hands-off regulation* for new emerging markets, as this is a key for innovation.
- *Telecoms markets definition and analysis* should be applied on a forward-looking basis and based on agreed principles of competition law[56].
- *Analysis of significant market power* within telecoms markets should be also based on agreed principles of competition law and applied on a forward-looking basis. Remedies imposed by National Regulatory Authorities should always be last resort decisions and be proportionate to the problems resulting from significant market power.

The BTRF should also address the following policy issues:

- Standards for interworking/interoperability.
- Non-discriminatory treatment of foreign telecommunications operators.
- Management of the spectrum, including spectrum allocation and spectrum trading.
- Cooperation in numbering plans.

Financial services

First of all, it is realistic to say that a single, fully integrated transatlantic financial market is not feasible in the short to medium term. Moreover, EU financial markets are still largely fragmented and consolidated at the national level. But an integrated transatlantic financial market can be accomplished in the long run.

Its benefits would be substantial[57]. Steil (2002) has estimated that full transatlantic integration of financial markets may lead to a 9% reduction of cost of capital for listed companies. Furthermore, greater competition between the

[56] See the section on *Decisions by Competition Authorities*.

[57] According to the data provided by B. Steil (2002), "*Building a Transatlantic Securities Market*, International Securities Markets Association, Zurich, pp. 17-23.

more efficient and automated trading structures on the EU side, and the more competitive brokerage industry in the US would reduce transaction costs by 60%, leading to an increase in trade volume of almost 50%. In addition, a mutually accepted accounting system would allow analysts on both sides of the Atlantic to trust firms" financial statements, leading to a higher transatlantic investment, and a decrease in the cost of the confusion and lack of credibility caused by converting accounts. Stronger integration would also foster competitiveness of the EU financial services industry, which lags far behind the US.

As Karel Lannoo points out, "The success of the EU in reforming its financial regulatory and supervisory structure led to the start of a regular dialogue with the US, which could be considered a model for other areas of transatlantic or bilateral trade cooperation[58]."

Dialogue has become a permanent feature, focusing on a broader set of financial market issues and involving the EU Commission and Lamfalussy Committees on the one side and the US Treasury, the SEC and Federal Reserve Board on the other[59]. As Lannoo highlights, the aim is "to improve understanding and identify potential conflicts in regulatory approaches on both sides of the Atlantic and to discuss issues of mutual interest".

The cornerstone of cooperation is "mutual recognition of equivalence"[60].

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[58] See Karen Lannoo (2005), *"A Transatlantic Financial Market?",* in Hamilton and Quinlan (eds.), op. cit.

[59] See the *Joint Report to leaders at the EU-US Summit on 25-26 June, 2004 by participants in the Financial Markets Regulatory Dialogue*, for the June summit held at Dromoland Castle, Ireland.

See http://europa.eu.int/comm/internal_market/finances/docs/general/eu-us-dialogue-report_en.pdf

[60] EU Commissioner for the Internal Market and Services Charlie McGreevy stated in New York on 20 May 2005: "The goal must be mutual recognition of equivalence. You can also call it the home-country principle. If you agree to accept each other's system as equivalent then duplicative requirements disappear. You can then operate in the other country under the rules of your home country." The conference was entitled: "The integration of Europe's financial markets and international cooperation", Concluding Remarks at the Euro Conference.

There is no full agreement on the terminology. While the EU uses the phrase "mutual recognition", US authorities prefer "equivalence", which may be more correct, as supervisory accountability remains at the federal level.

A perfect example of what is to be done as a result of the Atlantic Prosperity Area is the *Agreement On Equivalence between International Financial Reporting Standards* (IFRS) and *US Generally Accepted Accounting Principles (GAAP)*, reached between the European Commission and the US Securities and Exchange Commission (SEC) on April 22, 2005. It would allow companies to use one single accounting standard in the EU and US, and also US firms to continue issuing bonds on EU capital markets in the US GAAP, while the SEC will eliminate the need for companies using the IFRS to reconcile to US GAAP standards.

Another example is the agreement that followed the conflict regarding auditor oversight body resulting from the passage of the Sarbanes-Oxley Act in the US. The SoxA created the Public Company Accounting Oversight Board (PCAOB), and required all audit firms to be registered with the PCAOB, including EU-based audit firms with US-listed clients. The European Commission and the US PCAOB agreed on a "Declaration of intent on the equivalence of rules for auditor oversight" in March 2004, which would lift the requirement for EU-based audit firms. It stipulates, however, that EU member states should create auditor oversight authorities, which are not yet present in all member states, and agree on the European Union"s draft 8th Company Law Directive on the statutory audit, as a precondition[61].

In the supervisory side, the Committee of European Securities Regulators and the US SEC announced a cooperation agreement on June 4, 2004 covering increased communication about regulatory risks in each other"s securities markets and the promotion of regulatory convergence in the future.

The same form of extended cooperation is happening in the areas of banking and insurance, with the Committee of European Banking Supervisors and the Committee of European Insurance and Occupational Pensions Supervisors.

This process of cooperative dialogue must go on, but it should not take the way of reducing regulatory competition. Within certain limits, competition between regulatory regimes can be healthy.

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[61] See Karel Lannoo (2005), op. cit.

The agreements on the equivalence of rules for auditor oversight, accounting standards and supervisory policies are very positive steps, but there is still not agreement in several hard issues, such as the implementation of the Basel Accord and the direct access to EU exchanges by the US market[62].

Different rules to apply such Accord, both in the US and in the EU, would seriously distort the playing field for EU banks in the US, while US banks would have full range of choices in the EU.

A similar distortion can be found on regulated stock markets. While US-regulated markets are directly accessible for EU licensed brokers, the same is not true for EU-regulated markets in the US. Equal access for operators to capital markets in both the EU and the US can and must be implemented.

A coherent international business and governmental focus on good corporate governance is essential to both transatlantic and global trust. We have already referred to this issue. A good example is the progress made in the regulation of auditors in the Sarbanes Oxley Act, though more intense regulatory cooperation is needed.

EU-US convergence of listing rules must be implemented. EU-US agreements treating listing and de-listing rules as equivalent in the respective jurisdictions in pursuit of finally agreeing convergent approaches are needed. The EU has made some progress in this direction through its Prospectus and Transparency Directives. Reciprocal moves by the US would be very beneficial.

Action is also needed on regulation over admission to trading platforms. A common system of admission, opening access for qualified market participants to the electronic trading platforms of the EU and US exchanges is necessary.

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[62] As Lannoo (2005), op. cit., states, whereas the EU would leave all EU-licensed banks the choice of which approach to follow for the measurement of their minimum level of regulatory capital, US regulators would allow only the advanced internal ratings-based approach of the new Basel Accord to internationally active banks and apply the old Basel I framework to all the other banks. This action would seriously distort the playing field for EU banks in the US market, while US banks would have the full range of choices in the EU.

Blurred competences and incoherent policy positions amongst the EU and US regulatory and supervisory authorities must disappear. Tighter EU-US coordination of securities and banking regulation and supervision is essential. The Financial Markets Regulatory Dialogue must reinforce its current activity. Additional efforts to improve cooperation between the SEC and CESR are required.

On the EU side there is a need for the Commission, CESR and national financial services authorities to communicate and negotiate with one voice. Moreover, consistent and reliable application and enforcement of securities-market legislation and regulation in all 25 EU member states is a necessary condition for regulatory equivalence in EU-US financial market regulations.

On the US side, similar consistency between the regulatory and supervisory authorities is required.

Further progress is thus needed in the Financial Markets Regulatory Dialogue to promote a deep and open transatlantic capital market.

TABD recommendations in this field are the right ones:

1. Putting more effort into *ex ante* conflict prevention.
2. Equivalent application of the rules where common regulatory principles can be identified.
3. Regulatory impact assessments that take account of extra-territorial effects.

Air transport

As a result of progressive liberalization, airlines have been able to carry passengers more efficiently, which has brought down fares, both in the US and the EU. So the first question to negotiators should be why they do not immediately throw transatlantic skies open to the full forces of competition[63].

[63] The European Commission estimates that full liberalization could boost transatlantic passenger numbers by up to 11million a year, a 24% increase on routes with annual revenues of $18 billion.

What is more, the question is whether it would no be better to undertake a general liberalization process based on the Most Favoured Nation clause. It is not difficult to imagine a system of public auction of slots, to give a simple example. However, this possibility seems unrealistic, so that we have to try via the bilateral route.

The APA aims for a US-EU Open Aviation Area[64]. This initiative would lead to a free trade area in air transport encompassing not just transatlantic operations, but also those within the EU and the US.

However, EU-US talks on air transport had been stalled since the summer of 2004, and were only resumed in October 2005. Apparently, the EU is now ready to reach an agreement to liberalize transatlantic traffic[65], but we have heard that song before. So let"s wait and see.

According to The Brattle Group[66] the benefits of such initiative are conclusive. First, it would save costs by increased competition and consolidation; second, it would reduce fares (about $5.2 billion a year); and, finally, it would lead to an output expansion by the replacement of restrictive bilateral agreements (up to $8.1 billion a year). It is true, as Dorothy Robyn, James Reitzes and Boaz Moselle remark[67], that questions related to national security concerns, airline labour and aviation safety must be considered. However, there is no conclusive reason to think an Open Aviation Area would affect these questions negatively.

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[64] After a Court ruling in 2002, the European Commission wrested negotiating rights on aviation from the EU"s individual member states, raising hopes that efforts at liberalization would gather pace and that the collection of bilateral deals between EUmember states and the US would give way to a more comprehensive opening of the skies over the Atlantic. Direct talks between Brussels and Washington began soon after the European Commission won negotiating power and broke down in June 2005. See *The Economist*, 11 November 2005.

[65] "EU ready to resume "open skies" air talk", *Financial Times*, 6 October 2005.

[66] See Boaz Moselle *et al.* (2002), "*The Economic Impact of an EU-US Open Aviation Area"*, The Brattle Group, December.

[67] Cfr. Hamilton, Daniel S. and Quinlan, Joseph P. (eds) (2005), "*Deep Integration: HowTransatlantic Markets are Leading Globalization",* Washington, DC and Brussels: Center for Transatlantic Relations and Centre for European Policy Studies.

Efforts are needed in two directions. First, bilateral agreements between EU member states in the EU and the US should give way to an US-EU Open Aviation Area, where only the logic of the market and the rights of the consumers decide how carriers on both sides of the Atlantic can design their corporate strategy. Second, statutory limits imposed in Open Skies agreements such as the statutory limit on foreign ownership and control of domestic airlines, the stand-alone cabotage, the consecutive (fill-up) cabotage, the Fly America requirements, and wet leasing must disappear if we want to have a truly transatlantic aviation area.

Much disagreement centres on landing rights. Mergers among Europe's airlines have been stymied by the rights enjoyed by flag carriers at their national airports. Slots, governed by bilateral deals, determine which airline can fly where.

It is likely that even under an open skies agreement some barriers would persist[68]. With regard to transatlantic competition, the most striking barrier is the result of the nationality clause. This provision thwarts internal European liberalization and integration, acting as a barrier to EU airline"s consolidation, and, consequently, impeding the evolution of an efficient network design in Europe.

A second persisting and more fundamental impediment to full liberalization is the statutory limit on foreign ownership and control of domestic airlines.

US restrictions (along with the matter of landing rights) have prevented successful airlines from making cross-border acquisitions that could bring economies of scale and have also starved US' struggling airlines of foreign capital. As a trade matter, the ownership rules can be altered only with the approval of Congress. US politicians are reluctant to contemplate the foreign takeover of a leading American carrier. Ownership regulations are not even set to figure in the current discussions.

We should also mention barriers arising from the absence of mutual licensing recognition, and recognition of professional qualifications and diplomas of pilots and other technical staff.

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[68] See "Freeing the airways", *The Economist*, 11 November 2005.

Additional restrictions such as the stand-alone cabotage, the consecutive (fill-up) cabotage, the Fly America requirements, and wet leasing are included in "open skies" agreements.

The APA aims to remove all these impediments to ensure fully open skies.

TRADE DISPUTES: A PROPOSAL

As mentioned before, trade disputes only affect a tiny part of the transatlantic economy, but that is not a reason to forget about them. Bilateral trade disputes strain the relationship, fuel resentment, hurt innocent companies, have negative effects on bilateral trade and investment flows, and harm long-standing business relationships. Resources employed in trade disputes would be better allocated to increased cooperation.

Traditional trade disputes may be solved through mutual consultations or by means of the WTO dispute settlement mechanism. Regulatory conflicts are more difficult to solve, since regulatory cooperation is required. These mechanisms require appropriate procedures for mutual consultation and exchange of information, the implementation of commercial impact studies of domestic legislation, or mutual recognition agreements.

The *early-warning mechanism* set up to prevent disputes has produced conflicting results.

As Sir Leon Brittan has argued, old-style trade disputes such as the "banana war" may be "a blast from the past" but "regulatory obstacles constitute the main potential causes of dispute" in the future[69]. Enhanced cooperation between the United States and Europe "is not an optional extra, it is an economic, political and regulatory necessity".[70] The framework for EU-

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[69] Lord Brittan of Spennithorne (2000), "*Transatlantic economic partnership: breaking down the hidden barriers*", in George A. Bermann, Matthias Herdegen and Peter L. Lindseth (Eds), Transatlantic Regulatory Cooperation – Legal Problems and Political Prospects, Oxford: Oxford University Press, p. 17.

[70] Cfr. Alexander Schaub (2004), Testimony before the Committee on Financial Services, U.S. House of Representatives, May 13, p. 2.

Available at http://financialservices.house.gov/media/ pdf/051304as.pdf

US economic and regulatory policy cooperation and the institutional structures needed for political dialogue between both sides have lagged behind the developments in trade and investment. Yet, if integration is to be fostered, and if its implications are to be managed successfully, US and European policy-makers and regulators will have to catch up with their business counterparts and strengthen their cooperation substantially.[71]

However, realism is a must. The deep integration of the transatlantic economy makes trade disputes inevitable. A "zero trade-disputes scenario" is just wishful thinking. What we need is a proper framework to:

1. Minimize trade disputes, through regulatory cooperation and early-warning mechanisms at earlier stages in the regulatory (and legislative) processes, at the point of problem specification and solution identification.

2. Make a clear commitment to seek bilateral solutions to trade disputes, to using the WTO only as a last resort, considering this a civilized way of avoiding further damage, and to exercising restraint in the imposition of sanctions.

Thus, the APA agreement should provide a strong commitment at the highest political level to exhaust all the existing bilateral consultation and dialogue procedures before having recourse to the WTO dispute settlement mechanism as a last resort. All efforts should be made to avoid disturbing trade flows and long-standing business relations.

INSTITUTIONAL COMPETITION AS A CONTRIBUTION TO PROSPERITY

Topics such as whether the transatlantic economy is "balanced or imbalanced", the US foreign account deficit, or the euro-US dollar exchange rate are frequently raised for debate[72]. We believe much of this debate is misunderstood or wrongly addressed.

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[71] Cfr. Elles, J. (2005) "*The Transatlantic Market: A reality by 2015?*", Paper presented at the CSIS TPN meeting, April.

[72] Cfr. Daniel Gros and Thomas Mayer (2005), "*All quiet on the transatlantic front? Deficits, Imbalances and the Transatlantic Economy*", in Hamilton and Quinlan (eds.), op. cit.

A well-functioning Atlantic Prosperity Area does not need intervention in the foreign exchange market nor a harmonization of monetary and fiscal policies.

First of all, we think an EU-US intervention on the dollar-euro exchange rate is not a good idea. Even if it could be implemented, it would be largely ineffective. We have already explained that currency shifts have an uneven impact across the Atlantic because of the deep integration of corporate activity and the importance of intra-company investments, or related-party trade.

Secondly, and more importantly (as it is a matter of principle), citizens are better protected against harmful government policies through the power of free competition.

The same applies to fiscal policies. If tax competition is the rule even within the EU, it must also be so across the Atlantic.

Few things could be more dangerous for the general public than having all fiscal authorities or all central bankers constitute a cartel. The Atlantic Prosperity Area needs institutional competition in exchange rates, monetary policies, taxation, and public services, so that public goods are supplied and financed as far as possible according to the preferences of individuals.

Competition among currencies and their central banks helps them stay on the straight and narrow. Competition among taxation and spending regimes does not imply a race to the bottom, a trend towards zero taxes and endless deterioration of State services. Rather, it adapts the public sector to the choice of differently inclined citizens. In essence, it is a sort of Tiebout effect[73].

Two ideas are central to the opinion we have defended here. One is that as information becomes cheaper and more widespread, the influence on the

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[73] Charles Tiebout (1956), "A Pure Theory of Local Public Expenditures", *Journal of Political Economy*, nº 54, pgs. 416-424. If citizens can move among an array of communities which offer different levels of public service and correspondingly different levels of tax, they will move by voting with their feet. Some will choose low levels of tax and services, some high.

money economy of the real economy is lessened: people react to real incentives and discount money values. The other is that the real exchange rate cannot be managed by governments or central banks. The real exchange and the money exchange are not systematically related. If this is so, the competition between and flotation of currencies does not affect the real economy, except in that a good currency makes the calculation of future plans by individuals more accurate and thus contributes to higher growth[74].

THE PROMINENT ROLE OF TRANSATLANTIC DIALOGUE FOR A TO HELP THE WTO

The efforts of the Transatlantic Dialogues (business, consumer and legislators) should be encouraged. They are essential for maintaining the dynamism of the transatlantic economy and for re-energising the mechanisms of the EU-US summits.

Stakeholders on both sides of the Atlantic play a crucial role in putting forward new ideas on how to further the Atlantic economic relationship and inject new momentum into the relationship by specific proposals, mobilization of the political leadership, raising awareness about the vital importance of transatlantic relations, and building broad public support for transatlantic cooperation.

The new transatlantic policy dialogue can be very fruitful in seeking ways of raising long-term growth potential.

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[74] See. Jerry Jordan (2005), "*Money and Monetary Policy for the 21st Century*", Frazer Institute, 2005.

CHAPTER 6.
THE BENEFITS OF THE ATLANTIC PROSPERITY AREA

THE ECONOMICS OF ATLANTIC INTEGRATION[1]

Why is liberalization of goods, services, and factor markets desirable and what are the potential gains of extending these market reforms to transatlantic interactions? Free trade has long been recognized as a worthwhile policy goal because of potential gains from trade. Below is an outline of the established theories on the benefits to be gained from trade and factor mobility, which can be applied to the transatlantic economy.

The main tools that researchers have used to quantify these benefits can be classified as follows:

1. *General equilibrium model-based* studies. As the OECD recognizes, their main advantage is that the complex interactions between policy settings and economic outcomes are guided by economic theory and described within a well-defined framework designed to capture both the direct impact of any policy changes and the indirect feedback effects of such changes on economic activity and trade patterns.[2]

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[1] See Centre for Economic Policy Research (2002), "Enhancing Economic Cooperation between the EU and the Americas: An Economic Assessment", London, May.

[2] For example, the GTAP model is utilised to provide an independent estimate of the impact of changes in tariff levels on OECD trade and output, and to provide an assessment of these policy changes on non-OECD countries. See Hertel (1997) for a complete description on the GTAP model. Recent analysis conducted using this model is seen in OECD (2003) and references therein.

2. *Single-equation econometric studies*. Econometric approaches may better quantify the impacts of policy changes on economic outcomes given that the models are determined more by the experience of historical data rather than by any particular economic theory[3]. Moreover, many of the static gains from structural policy reform may derive from the take-up of slack in production (or X-inefficiencies). These are generally not included in traditional general equilibrium frameworks. On the other hand, econometric studies are less able to capture the impact of any indirect changes in policy settings, such as trade diversion effects, changes in relative prices, and the feedback of changes in one country's growth potential on growth in the rest of the world. Given their reduced-form nature they are also generally unable to disentangle what the transmission mechanisms behind changes in policy settings and economic outcomes are.

Gains from trade: traditional arguments[4]

Gains from trade arise from a number of sources, encompassing the traditional arguments of competitive trade theory (the Smith-Ricardo and Heckscher-Ohlin theories of comparative advantage) and the new trade theory that acknowledges economies of scale and differentiated products.

Comparative advantage

The traditional explanation for the existence of trade between any two nations is the theory of comparative advantage. According to this theory, trade arises because of underlying differences between the countries, such as differences in technology, factor endowment disparities, and differences in

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[3] See Nicoletti and Scarpetta (2003), Nicoletti et al. (2003), Bassanini et al. (2001). A common criticism of using models based on the historical data to quantify the impact of any future reform is the well-known Lucas critique, i.e. that the estimated coefficients of the models themselves may change as a result of reform, so that estimates of the benefits may be unreliable -see Lucas (1975). Some panel data studies may mitigate this concern (e.g., if coefficients estimated for a certain country sample incorporate a broad range of historical policy-settings, so they are likely to be more robust to changes in policy regimes). However, returns to policy reform from reduced x-inefficiencies may well be declining, so coefficients may exaggerate the effectiveness of additional reforms.

[4] Cfr. CEPR (2002).

national tastes. International trade permits resources to be allocated more efficiently between the countries. Each country exports the goods in which it has a comparative advantage. Exploiting comparative advantage results in mutual overall gains to both countries.

Scale economies and product differentiation

The existence of increasing returns to scale in production may mean that an individual country's domestic market is too small for efficient production. Trade liberalization may permit the rationalization of production into a smaller number of plants, resulting in the benefits of large-scale production.

Moreover, many products are frequently differentiated from one another, embodying different characteristics. Access to a wider range of varieties through international trade yields additional benefits to consumers through increased choice.

Regional trade agreements as substitutes for multilateral liberalization

Regional trade agreements lead to an increase in intra-regional trade flows, sometimes at the expense of inter-regional flows.

Poland, for example, since its integration in the EU has seen its exports to the EU rapidly increase at the expense of extra-European flows. Canada, since its integration in NAFTA, has seen its exports towards Europe fall in favour of intra-American flows.

As tariff reductions are only for imports from the country's partners in the regional trade agreements, relative prices of imports from partners and non-partners become distorted. As a result, a country may switch its source of imports to a partner, despite the non-partner being the cheaper source. This can eventually be the cause of a country losing from membership of a regional trade agreement. We are talking about trade diversion.

These undesirable side effects of regional trade agreements can be offset by broadly-based trade liberalization, e.g., multilateral trade agreements, such as the successful completion of a round of the WTO.

Failing this, major trading partners can seek to reduce barriers to trade between them as a complement to their regional trade agreements. Open regionalism based on MFN principles is the best way togo.

Side effects of trade: dislocation and income redistribution

Despite the aggregate benefits that trade generates, there are potential problems, both in the short and long term.

In the short term, there may be adjustment costs due to resource reallocation in a country or region. While those sectors of the economy in which a country has a comparative advantage are expected to grow, others will decline. This may result in regional unemployment, obsolescent skills, or redundant capital.

Further, international trade may have long-lasting effects on the distribution of income within a country. While the earnings from some factors of production will decline, others will rise. This can result in strong political lobbying on behalf of the detrimentally affected factors, seeking compensation or protection against import penetration. However, the appropriate tools for dealing with any such detrimental aspects of trade liberalization are domestic, for example restructuring assistance or competition policies, not protectionism.

Abuse of market power

A clear implication of the rationalization arising from increasing returns to scale is the reduction in the number of firms in an industry. The more concentrated an industry, the greater the market power of its incumbents, and the greater the risks of the abuse of this power.

There is a counter to this argument for an individual nation. While we expect fewer firms at a global level as a result of trade liberalization, there may in fact be more competition within a country, as domestic firms are faced with international competitors, disciplining their behaviour in the marketplace.

Dynamic gains

Beyond the static gains are the less easily quantifiable effects that a liberal trade environment may have on a nation's growth.

For many industries in countries near the technological frontier, dynamic gains through greater innovative efforts may well be the most important long-term effects of liberalization and/or reductions in anti-competitive regulation.

A key factor determining the rate at which technical progress takes place is the intensity of research and development (R&D) and other innovative activities[5]. In theory, raising R&D intensities would be expected to lift long-term growth as productivity-enhancing technologies are developed[6].

There is a large empirical literature on the effects of openness on growth. Wacziarg (2001) examines the links between openness to trade and economic growth, showing that openness does have a positive impact on economic growth, with the majority of the effect being through the increased accumulation of physical capital induced by greater openness[7].

It has been argued that technological spillovers and the international transmission of knowledge through international trade can accelerate a nation's growth.[8] Exposure to rival firms in the marketplace may also force enterprises to imitate or innovate, inducing higher growth.

Lowering trade barriers reduces the distortion in domestic prices and encourages a country to specialize according to its comparative advantage,

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[5] Empirical evidence suggests that strict product market regulations can have a significantly detrimental impact on R&D in both the public and private sectors. Based on recent OECD empirical evidence, the average decline in a certain package of product market regulations could permanently boost R&D expenditures (relative to GDP) by around 11%, and the total level of patents by around 5%, on average across the EU and the US.

[6] See Ahn (2002).

[7] However, the robustness of these results has been widely questioned, largely on the basis of the difficulty of separating the effects of openness from other aspects of economic reform.

[8] See Grossman and Helpman (1991).

a static gain from trade. But it has also been shown that such price distortions adversely affect capital accumulation and growth.[9] Thus, trade liberalization can encourage growth through the elimination of these distortions.

"New" international trade theory.

The strong argument in favour of trade liberalization was correct when trade research was couched in terms of perfectly competitive market structures. The arguments in favour of a more liberal trade regime are reinforced by the positive impact that openness appears to have on a country's growth rate.

"New" trade theory has taken into account the presence of increasing returns to scale and differentiated products.

A role has been found for a "more active trade policy" which is a synonym for trade distortion and trade protection. Unfortunately, "new trade theory" has been wrongly interpreted by some people, since in most circumstances increasing returns to scale and differentiated products can be better addressed using domestic instruments such as competition policy rather than trade restrictions. On the top of that, this theory has provided ammunition for protectionists to argue in favour of government intervention through trade restrictions or public intervention (e.g. public subsidies). However, in most contexts new trade theory suggests that the benefits of bilateral or multilateral trade liberalization are greater than are suggested by comparative advantage alone.

International factor mobility

International movements of labour

International labour movements could have significant effects on production and efficiency. They have been relevant worldwide, but especially across the Atlantic as a result of migrations between Europe and the Americas.

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[9] See Easterly (1989) and Easterly (1993).

Labour migration can be a substitute for international trade. A labour-scarce economy may either import goods that are labour intensive, or permit immigration of labour and manufacture the goods itself.

But labour migration can also be complementary to trade in goods. Thus, for example, movements of highly-skilled technicians might accompany exports of sophisticated IT equipment.

Immigration of workers raises many tricky issues resulting from increased competition in the labour market and complex problems involving questions of citizenship, access to the welfare state, etc.

However, immigration of skilled workers could foster exchanges of ideas, more rapid assimilation of technology, and enhance trade in goods.

Capital movements: financial capital liberalization

The benefits for investors of holding capital in more than one country are twofold. First, it allows for risk pooling. To the degree that shocks are less correlated across countries than within countries, investors can spread risk through holdings not only across sectors, but also across nations. Further, movements of financial capital across international frontiers will equalize the cost of capital, making investment in capital-scarce economies cheaper than it would otherwise be.

The perceived disadvantage is the exposure of countries to speculative movements of capital. In response to negative economic shocks, there may be a dramatic exodus of financial capital, resulting in extreme pressure on exchange rates. However, dramatic and massive financial capital outflows are rarely stochastic. Usually they are the result of accumulated imbalances harvested by mistaken economic policies.

Capital movements: Foreign direct investment

Foreign direct investment (FDI) is associated with transfers of capital as well as with international relocation of a package of technology, management skills, and brand reputation. These investments result in increased domestic employment,

both directly by employment of domestic labour by the foreign firm and through increased demand for inputs of domestically produced goods and services.

There may additionally be dynamic gains, whereby domestic firms may emulate the managerial and production practices of the foreign firm, resulting in spillovers of knowledge. There may be few spillovers when the domestic operations of the multinational involve basic low-skilled employment with no local research and development activity. While the benefits of FDI for host countries may depend on the type of FDI, empirical evidence suggests that inward FDI has important implications for economic development, especially when it creates positive spillovers for the host economy in terms of knowledge. This is certainly the case of transatlantic FDI capital flows.

ASSESSMENT OF THE BENEFITS OF FULL ATLANTIC ECONOMIC INTEGRATION

The interest in a renewed Atlantic initiative has resulted in several reports on the potential benefits of full transatlantic economic cooperation produced by top research centres in the last few years. The most revealing work in this field is in our opinion that published by the OECD in 2005.

The OECD's 2005 comprehensive study on the opportunity costs of insufficient market liberalization and limited economic trade and investment integration between the two sides of the Atlantic could play the role of the 1990 Cecchini Report in the EU. It assesses the cost of this non-transatlantic economy using the most recent data and accounting for effects of market liberalization, trade opening and removal of barriers to FDI. The OECD estimates that further transatlantic liberalization could lead to permanent per capita income gains in the US and Europe of up to 3%-3.5 %, i.e. the equivalent of a full year's income across a working lifetime.

The 2005 OECD Report[10]

The OECD study provides an assessment of the potential long-term trade and output returns accruing from a package of structural reforms in the

[10] *OECD (2005),* "The Benefits Of Liberalising Product Markets And Reducing Barriers To International Trade And Investment: The Case Of The United States And The European Union", *Economics Department Working Paper 432, Paris.*

European Union and the United States that enhances product market competition, reduces broad tariff barriers and eases restrictions on foreign direct investment[11].

Structural reforms dealing with product market competition cover a broad range of policy measures coping with regulation that generates obstacles to free market forces, including barriers associated with State control of companies and State involvement in business operations in the form of administrative barriers to start-ups, administrative opacity and barriers to competition. However, the scope of liberalization illustrated in the study focuses only on some types of barriers. Environmental or safety regulations, most public interventions in agriculture, all labour market and financial-market regulations, and the distortions induced by welfare systems are not considered.

The key results of the OECD study with respect to gains in economic performance are:

1. At the level of the OECD area as a whole, exports are estimated to increase by up to 25% while GDP per capita levels increase by around 1.25% to 3%, depending on the analytical approach used to estimate the gains[12]. It should be stressed that these gains are permanent. As the OECD states, over an average 40-year working life of an individual, the accumulated addition to earnings would equal between one-half and over one year's worth of earnings.

2. In the US, the reform package is estimated to boost GDP per capita by around 1% to 3% per capita. Reductions in domestic product market

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[11] In this paper, "European Union" refers to the 15 member states prior to the 2004 enlargement. The specific features of the reform package considered in the OECD paper are inferred from OECD estimates of the current gaps between EU and US structural policy settings and measures of what are considered to be best-practice policies across OECD countries. The analysis of the impact of reforms on trade and output is based on earlier regression results obtained by the OECD, supplemented by general equilibrium analysis using the Global Trade Analysis Project (GTAP) model. It is assumed that the reductions in the external barriers to trade and investment in the European Union and the United States apply globally. Hence, the estimated benefits of reform are spread across all OECD countries and the rest of the world.

[12] This increase in GDP per capita would be equivalent to the expansion that would be expected over one to two years when OECD economies are growing at around their potential growth rates.

reforms play the most important role in explaining this improvement in economic performance, followed by reductions in external barriers to trade and investment.

3. In the EU, per capita gains in GDP are estimated to be around 2% to 3.5%, with the majority of EU countries fairly close to this average[13].

4. In the OECD area outside the United States and the European Union, output per capita could increase from around 0.5% to 2%[14]. Spillovers outside the European Union and the United States may thus be large: 2% for Canada and Mexico, 1.5% for Turkey, Japan and Central Europe.

The size of these gains should be seen in the context of the scope of the policy reforms considered. The scope of the reforms is quite deep with respect to competition-restraining regulations in product markets, FDI restrictions and external tariff barriers. Indeed, a shift to best-practice policies implies a more liberal overall policy stance than any seen in an OECD country at present. On the other hand, the reform package is relatively narrow as it excludes reforms to labour markets, financial markets, agricultural support and taxation, all of which could strengthen economic integration and performance. It is also important to note that the reforms considered concern reform of competition-restraining regulations only. Regulations governing health and safety standards and the environment are not included in the measures of the regulatory stances, nor are they envisaged as areas in need or reform.

Such liberalization efforts are not unprecedented in the OECD. For example, for the United States and some members of the European Union, the reform intensities implied are only moderately larger than those seen over the 1998-2003 period.

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[13] The larger estimated benefit of reform for the European Union relative to the United States reflects that structural policy settings for many EU countries tend to be further removed from best practice, especially policies governing domestic product-market regulation.

[14] As the study only considers policy reform in the European Union and the United States, the output gains in other OECD countries stem only from an increase in their trade levels as barriers to trade with the European Union and the United States are reduced, and the associated expansion of their output-generating capacity.

The 2002 CEPR Report and the 2002 study by the Istituto Universitario Europeo

Two excellent papers, one already cited from the Centre for Economic Policy Research in 2002[15] and another from the European University Institute also published in 2002[16], centred on the economic relations between the EU and the US, are also obligatory reading. The latter study describes in detail the various bilateral initiatives launched and the institutional framework and dialogues (business, parliamentary, consumer, environmental). In its conclusions, it proposes that regulatory cooperation should be more fully studied, and sets out three objectives:

1. Drawing up an inventory of regulations which are potentially restrictive for trade and investment at all levels of government.
2. A detailed study of all forms of regulatory cooperation existing between the EU and US.
3. A systematic analysis of all the possible forms of conflict resolution, particularly of a regulatory nature.

The CEPR study analyses the potential benefits of an improvement in economic cooperation between the EU and the Americas (the US, Canada, Mexico and the rest of Latin America) through a positive liberalization agenda. The study aims to identify the benefits which would derive from a greater integration between the European Union, the United States, Canada and Latin America.

Thus it is not a specific study on the economic relationship between the EU and the US, nor does it cover proposals on how to put into practice a full transatlantic liberalization.

Taking into account the barriers to trade and investment between the various economic areas, the CEPR offers estimates of the potential benefits resulting from their elimination. Its estimates of liberalization following

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[15] Centre for Economic Policy Research (2002), "*Enhancing Economic Cooperation between the European Union and the Americas: An Economic Assessment",* London, May.

[16] Istituto Universitario Europeo (2002), "*The Economic Policy of the Transatlantic Association"*, Florence, March.

Messerlin (2001) show that the static gains from EU liberalization towards the Americas range between 0.7% and 0.9% of EU GDP in 1990. These benefits are annual gains accruing in perpetuity. The elimination of trade barriers should result in about one million extra jobs in the EU[17]. However, static benefit gains underestimate the true gains[18]. Taking other issues into account is likely to push up gains for the EU to a range between 1% and 2% of GDP.

CEPR's trade-weighted estimates of static US gains from tariff liberalization in goods trade with the EU based on the Hufbauer-Elliott (1994) study indicate an estimated increase of 0.2% of US GDP in 1990, which translates to an additional 0.3 million US jobs[19].

Recent studies give reason to believe that these gains are once more an underestimate of the true effects[20]. According to the CEPR report, taking these issues into account results in tentative estimates of gains for the US from liberalization with the EU in the range of 0.5% to 1% of US GDP on an annual basis.

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[17] These figures correspond quite closely to those reported by the European Commission in the *"New Transatlantic Market Place: an analysis of economic impact"* (1998), where the gains of tariff liberalization on industrial goods on a MFN basis would result in an increase of EU GDP by 0.7% annually.

[18] First, the Messerlin (2001) study only includes a limited number of service sectors, due to a lack of available data. Highly protected sectors, such as maritime services and financial services, are left out. Furthermore the analysis is based on data for 1990. During the nineties, trade flows between the EU and US substantially increased.

[19] Again this welfare figure corresponds quite well with the EU Commission (1998) estimate, which calculated gains for the US of eliminating tariffs on industrial goods on a wide MFN basis that amounted to 0.5% of US GDP annually. According to this same study, the gains from industrial tariff reduction for other North and South American countries were Canada 0.03%, Mexico 1.78%, and Latin America 3.32% of GDP. Weighting these with the import shares of EU imports to total imports of each of these countries gives us a rough idea of the gains resulting from tariff liberalization with the EU, namely 0.01% of GDP for Canada, 0.02% for Mexico, and 0.3% for Latin America.

[20] First, the studies only discuss tariff barriers on trade in goods. Since we know that services constitute the largest part of the US economy, including them in the analysis will push up gains. Secondly, non-tariff barriers and dynamic gains are not covered by these studies. Finally, the studies were carried out under constant returns to scale and using 1990 data. Allowing for increasing returns to scale and including the higher trade flows between the US and EU today is likely to generate higher gains.

The predominant reason for the smaller gains on the US side is the higher level of market segmentation that exists today in the EU. The additional gains being reaped by the EU are a result of the pro-competitive effects of trade liberalization on the domestic marketplace.

Gains from inner liberalization of EU trade in services

Most harmful hurdles in the transatlantic economy being within the EU, some research has been produced on the gains resulting from inner EU liberalization of trade in services if the Bolkenstein Directive were implemented. Deep integration in the transatlantic service economy would also result in a boost of US direct investment in the EU.

Copenhagen Economics has estimated that liberalization would yield significant economic benefits to the EU through efficiency gains and enhanced productivity leading to higher employment, increased wages and lower prices. The total welfare gain would be of 0.6% of EU GDP, or €37 billion. Up to 600,000 jobs would be created, real wages would increase by 0.4% and foreign investment would be boosted by up to 34%.

Gains are likely to be higher and to benefit the world

First, it must be highlighted that "structural reforms enhancing market competition" and "investment liberalization" are considered separate issues in the OECD study. Are they really different? To a certain extent, they mean the same thing, given the deep integration of both economies. Some of the structural reforms will be mostly effective domestically, especially in markets for non-tradable or not easily-tradable services. On the other hand, other reforms opening markets to competition mean both supply-side domestic reforms and investment liberalization.

Secondly, both the OECD and CEPR study recognize that their estimates should be treated cautiously. They also state that they are conservative estimates. The OECD, for example, says that "The magnitude of estimated output gains may seem modest to some observers. However, estimations of the gains of liberalization are quite prudent, as only "one-shot" or "static gains", coming from greater international trade specialization and better allocation of resources, are assessed."

There are indeed good reasons for considering that these estimates are on the low side for the gains to be generated by mutual economic liberalization.

1) The economies of the European Union and the United States are to a large extent service economies. However, there are not many figures available on trade in services and the barriers affecting it. Some highly protected sectors, such as maritime services and financial services, are left out[21]. Thus it is difficult to quantify the gains from liberalization in this area.

2) *Non-tariff barriers* can be better covered.

3) *Increasing returns to scale* should be properly considered.[22]

4) Estimates should be calculated using *the most recent data*, taking into account the ever-increasing trade flows between the EU and US.

5) Most importantly, *dynamic gains must be accounted for*. The studies mentioned above look at first-order direct effects of trade liberalization and only include static gains from trade. An enlarged transatlantic marketplace would also give rise to dynamic gains. For example, liberalization and competition could result in increased incentives to undertake research and development or increased innovative efforts, which in turn would accelerate productivity growth in both the EU and the US. These effects have not been considered in calculating the gains. In fact empirical research indeed suggests that the gains could be quite large although their estimated magnitude still has a substantial margin of uncertainty.

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[21] Liberalization in the financial sector may also raise welfare estimates substantially. Mattoo et al. (2001) constructed a measure of openness for financial services and telecommunications, sectors that were omitted in the Messerlin (2001) and Hufbauer-Elliott (1994) studies. This indicated that developing countries that fully liberalized these sectors tended to have annual GNP growth that was up to 1.5% greater during the 1990s. Of course, countries such as the EU and US have long had more open financial sectors than most developing countries and consequently the predicted gains would be smaller. Francois and Schuknecht (1999) have also confirmed this strong link between financial sector openness and growth.

[22] For the US, the CEPR analysis was predominantly carried out under constant returns to scale. Allowing for increasing returns to scale is likely to push estimates up. For example, in a study assessing NAFTA through computed general equilibrium (CGE) models, US gains went up by almost 1% from 1.67 to 2.55 %, with even higher increases for Canada and Mexico. See Roland-Holst *et al.* (1992).

Other studies have looked at the dynamic long-term gains that can result from increased R&D activity or technological progress as a result of trade liberalization, which are believed to push gains up still further. Another example of dynamic gains is increased labour productivity. These dynamic gains are more difficult to quantify[23] but could yield long-term growth benefits whose effects dwarf short-term static gains.[24]

Thus increasing returns to scale in production, dynamic welfare gains and gains from the liberalization of services are important factors that should be included when discussing gains from liberalization. All this means the estimates for gains listed above are on the low side compared with what is likely to be the true effect of liberalization. Adding up the previous effects, the CEPR report tends to upper estimates of EU GDP growth gains ranging between 1% and 2%[25].

Overall, the gains from reforms may be considerably greater than those presented in previous studies.

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[23] See Baldwin and Venables (1995).

[24] A study on the impact of the Canada-US FTA on labour productivity suggests that tariff reductions helped boost manufacturing labour productivity by a compounded rate of 0.6% to 2.1% per year (see Trefler 2001). These gains are achieved not through scale effects or investment but through plant turnover and rising technical efficiency within plants. This suggests that productivity gains from liberalization may actually be more important than standard gains. Hence dynamic gains are likely to have a multiplicative impact and push up the static welfare estimates discussed above.

[25] The European Commission (1998) study on the welfare effects of trade liberalization with the US, when incorporating non-tariff barrier elimination and the liberalization of the service sector, finds a total gain of 1.1% of EU GDP. This study did not allow for the long-term indirect effect of trade liberalization. For the US, gains from opening up to the EU are also likely to rise once increasing returns to scale are incorporated. A study on the impact of NAFTA showed an additional 1% increase of GDP for the US over and above the gains under constant returns to scale – see Roland-Holst *et al.* (1992). If we consider that the EU is an even larger trading partner for the US than its NAFTA partners, allowing for increasing returns to scale in production is likely push up the static gains for the US from liberalization with the EU. Taking into account the potential gains from liberalization of financial services and considering the labour productivity gains that liberalization has been shown to generate -see Trefler (2001), a more optimistic estimate of gains for the US would range between 0.5% and 1% of GDP.

The upper-bound gains from transatlantic liberalization estimated by the CEPR in 2002 can usefully be compared to the estimates reported in the original Cecchini Report on the implementation of the 1992 Single Market programme. There it was estimated that removal of internal barriers in the EU would increase GDP by between 3% and 4%.

The rest of the world is likely to benefit from these gains. The EU and the US are the two biggest economies in the world, so the spillover effects would be certainly large.

CHAPTER 7.
THE MULTILATERAL DEVELOPMENT AGENDA

THE DOHA DEVELOPMENT ROUND

Failure in Hong Kong and Cancun

Three of the last four WTO Ministerial Meetings have been unsuccessful: the Hong Kong meeting in December 2005, the Cancun meeting in 2003 and the Seattle meeting in 1999. This deserves some reflection on its causes and consequences.

The Cancun failure resulted in an overall impasse in the Doha Round, and a delay in its conclusion, which was initially thought to be 2004. It was postponed additionally, after problems caused by the political timetable including presidential elections in the US, a new European Commission in 2004, and the appointment of a new Director-General of the WTO in 2005 (finally the job went to Pascal Lamy, former EU Trade Commissioner).

The Ministerial Conference held in Hong Kong in December 2005 has produced deceiving results. Little more than the political commitment of developed economies to gradually remove export subsidies in agricultural products by 2013.

The negotiation issues

After the failure in Cancun and Hong Kong, the debate on the negotiation agenda was reopened to decide whether some of the items should be dropped.

First, there are the *Singapore issues*, which have been debated for eight years. Secondly, there are other subjects which some consider should be excluded from the WTO since they are considered of a "special" character (the audiovisual market and the "cultural exception"). Thirdly, some NGOs want to exclude chapters dealing with sustainable development from the agenda.

Much controversy comes from the debate on potential rules dealing with labour standards and the related (and unfair) issue of "social dumping". Even the negotiation of the WTO Agreement on Trade in Services has become a controversial item.

Even after Hong Kong, it does not seem reasonable to water down the Round by excluding a number of important issues: the Singapore issues, the development of the WTO agreement on trade in services, the negotiation of allegedly special sectors or those subject to "cultural exceptions", or subjects related to sustainable development.

The new negotiation groups. The South-South Agenda

In all the GATT (and now WTO) negotiation rounds up to now, agreement between the EU and US was considered a necessary and almost sufficient condition for the success of the negotiations. Failure in Seattle, Cancun and Hong Kong has showed that an Atlantic agreement is no longer sufficient for the success of a WTO Round.

The appearance of groups of countries with similar interests which negotiate together helps the negotiation procedure to work between so many participants, but can also produce more inflexible positions. Many different and heterogeneous negotiating groups have appeared, making global agreements much more difficult. It has also become clearer that not all developing countries have the same interests, and the traditional North-South divide has been breached. Serious discrepancies exist even among groups representing developing countries.

The South-South agenda is also important and must be supported by the EU and the US. This means the G20 must accept an ambitious market-access agenda. It also means that advanced developing countries need to be

prepared to extend preferences to the weaker part of the WTO membership, following the Brazilian example.

Some people think developing countries showed their muscle in Hong Kong and Cancun. While this may be true, it is not clear who benefited from this show of strength. The main losers of the Doha impasse have been the citizens of developing countries, especially the poorest ones: in fact, those for whom full integration into the global economy is the key for emerging from poverty.

As the Director of Studies for the IMF, Ken Rogoff, said, the collapse of Cancun was "a tragedy, given that without stronger trade, global growth will be significantly reduced and global poverty will increase".

Success at Hong Kong would have produced clear changes in agricultural policies in wealthy countries. The poor and clearly insufficient result (an agreement to remove export subsidies in agriculture by 2013) is quite deceiving. What is more, success at Hong Kong would have made possible a swift completion of the Round, a resultant reduction in protection in the agricultural sectors, and an opening up of markets for all, but above all for developing countries which would have benefited from a more favourable treatment.

The responsibility for the impasse

Blaming just the EU and the US for the failure in Cancun and Hong Kong is completely unfair. In fact, it's simply not true. There is no question that both the EU and the US were quite flexible in their positions. It is worth remembering, for example, that the US accepted a difficult agreement on pharmaceuticals shortly before Cancun. And both the US and the EU have accepted some reforms in agriculture in Hong Kong, while no substantial efforts were seen in other negotiating parties.

The EU and US offers were undoubtedly negotiable. By contrast, a proportion of the developing countries had excessively radical positions. In some cases they were undoubtedly of a tactical nature, but they were caught in a corner from which it was difficult to back out. As a result, they have to bear a large part of the blame for the failure of the Round.

What is more, some negotiators undoubtedly had "hidden agendas" which went far beyond the official speeches in the meetings. Some WTO member states preferred failure in both Ministerial Meetings to success, for reasons which they would probably never admit.

One of the reasons was certainly the competitive power of China after its entry into the WTO. Some developing countries refused to reduce their trade protection for fear of Chinese competition, but they would not admit it openly and concealed their defensive positions behind what they said were the insufficient proposals of the EU and US. Another underlying cause was pressure from the finance ministers of some countries who feared to lose public revenues from customs duties.

Another equally conflictive subject was the negotiation of the Singapore issues. It is undeniable that the implementation of these issues would result in greater discipline and less arbitrariness, or we could say more legal security, with positive effects on economic freedom, regulatory transparency, capacity for attracting foreign investment and efficiency of the economies of developing countries, with resulting positive effects on their prosperity.[1] All this once more may not have been to the liking of some developing countries, and it was not difficult to camouflage the resistance to implement the Singapore issues with the alleged insufficiency of the EU and US proposals.

The regional way

The failures of Seattle and Cancun (and now, Hong Kong) have boosted regional trade agreements, now that it is increasingly clear that it is difficult to reach agreements in the WTO. Bilateral trade agreements are easier to negotiate and are more politically visible.

It should be remembered by those who have a large part of the responsibility for the failures at Seattle, Cancun and Hong Kong that in these kinds of agreements the strong can more easily have their way. Apart from

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[1] Peter Mandelson (2005), "Trade at the Service of Development: An action plan for 2005 for the EU Trade Commissioner", lecture at the London School of Economics, 4 February 2005; cf. Marc A. Miles et al. (2004), "Index of Economic Freedom", The Heritage Foundation, US.

this, dedicating more attention and effort to bilateral negotiations may also weaken interest in the WTO. This should be a matter of reflection for those travelling to the next WTO meeting with radical positions.

In this respect, we must recall that the rules-based system of the WTO fundamentally protects the economically weak against the strong and powerful. It is often forgotten that this is why all members of the GATT agreed to establish a new, binding system for settling disputes and to outlaw all unilateral measures.

This is why regional agreements cannot and should not substitute the WTO as an organization or forum for negotiations. The WTO is an asset of incalculable value for all, with a capacity which only it can offer to allow agreements which are sufficiently wide-ranging to satisfy all the participants in a negotiation, and thus allow liberalization in areas which are difficult to deal with in more limited bilateral agreements. Among other things, it has a dispante settlement system which all countries subject themselves to, and which allows the smallest to challenge non-compliance by the largest on an equal footing. The WTO is a simply irreplaceable organization when it comes to promoting common and clear rules and fair treatment for all in international trade.

However, as with every institution, it can be improved. The experience in recent Ministerial Conferences suggests some possible reforms.

WTO working rules

The former EU Commissioner for Trade and current WTO Director-General Pascal Lamy stated after the Cancun failure that “the WTO is a middle-aged organization”. He was probably referring to the consensus rule for taking decisions, which is not very practical when negotiating with 148 members.

The experience from Seattle and Cancun shows that some WTO working rules need to be reviewed. Cancun, for example, made it clear that the chairman of the Ministerial Conference had too much power to run the meeting.

So the EU and the US should make a joint proposal to reform the working rules of the WTO on at least two points:

— Decision-making rules, to prevent the impasse produced by the present rules.

— The rules related to the powers granted to the President of a Ministerial Conference.

THE US AND THE EU JOINT COMMITMENT TO THE FULL INTEGRATION OF EMERGING AND DEVELOPING NATIONS INTO THE GLOBAL TRADE SYSTEM

Access of developing countries' products to EU and US markets

The EU and the US are the two greatest markets in the world. Though the Sachs Report argues that developing countries themselves have a tendency to exaggerate the role that trade can play in solving their development problems, opening the markets of developed countries to emerging economies and less developed countries is a necessary condition for their development and for their citizens' prosperity. All this can and must be achieved through the multilateral framework provided by the WTO.

We have made big progress in the right approach to development policies. Governments, NGOs and think tanks have all contributed to educate public opinion. Until the Uruguay Round in the 1990s, trade was seen as largely separate from development. Trade was basically about dismantling the walls of protectionism erected in the inter-war period that destroyed the pre-1914 good old days of globalization based on free trade and the Gold Standard.

The establishment of the WTO inclusive rules-based system brought the issues of trade and development together in what was perhaps an unforeseen way. The WTO membership expanded in total from 90 to nearly 150 in a decade, of whom three-quarters are developing countries. Yet most developing countries joined the WTO only to react, in a short space of time, against what they saw as the biased rules of an old club.

With help from NGOs, and increasingly articulating "trade justice" as an issue, they latched on to the Cairns Group's campaign against agricultural

protectionism. There are indeed solid arguments in favour of the trade injustice position regarding agricultural protectionism.

Developing countries and NGOs extended their criticism to intellectual property rules. Sometimes perhaps they were justified, as for some of them it was impossible to access the necessary medicines to treat HIV-AIDS, for example.

Moreover, developing countries rejected the concept of "core labour standards". Their attack against developed countries using the argument of covert protectionism was strategically wrong, but there are solid arguments to reject developed countries' accusations of social dumping.

Developing countries have also insisted on the withdrawal from the Doha Round of three of the Singapore issues designed to extend international rule-making to an economic agenda of investment, competition and public procurement. They are wrong on this point. Developing countries, more than developed countries, benefit from transparent procurement rules, a predictable climate for foreign investment which they badly need, and effective competition authorities to ensure a level playing field. Moreover, the Singapore issues are perfectly compatible with wide degrees of freedom to make domestic choices.

We should complete the Doha Development Round in a way that offers something for all, driven by the objective of promoting sustainable development for developing countries. We must re-commit the developing world to the WTO system as the core safeguard of their interests.

"The issue" is agriculture

Let us return to agriculture. The EU and the US have an historic opportunity to fundamentally reform agricultural policies, opening up their markets and getting rid of trade-distorting subsidies[2].

As a result of Hong Kong, they are supposed to remove export subsidies on agriculture by 2013. 2010 would have been a better date for completion,

[2] See Daniel Griswold et. al. (2005), "Ripe for Reform. Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers", CATO Institute, September 14.

and the US was ready to accept this target, but the EU refused to do so. And we must recall that, in July 2004, the EU offered to phase out all agricultural export subsidies as long as other developed countries followed suit[3]. Anyway, American and European taxpayers will benefit from this partial reform.

However, agriculture will remain as a deeply subsidized and protected sector both in the EU and the US. This continues to be the main obstacle for a successful conclusion of the Doha Development Round. Additional progress on agriculture would spur on negotiators to push through proposals on services and non-agricultural market access.

Preferential access to EU and US markets

EU quota regimes for special products such as sugar and bananas have been the lifeblood of some ACP countries for decades[4]. The US holds similar preferential agreements with some other countries. However, European preferential treatment of ACP countries has failed to raise their share of EU trade, and has also failed to boost sustained growth. We must reflect on these facts. It is probably a case of the "subsidy trap".

Moreover, the protectionist market regimes that shelter these countries from competition are simply unsustainable in the context of the DDA. New policies based on capacity-building approaches are needed to lift these countries out of desperate poverty.

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[3] We must also warn of the short-term effects of these reforms. Subsidies depress food prices on world markets. Once the subsidies have disappeared, food prices will on balance rise, eroding the purchasing power of many families and making life more difficult for net food importers, including many African countries. In the medium to longer term, this reform will create the right incentives for developing countries to become successful agricultural exporters themselves. More advanced countries will gain immediate benefit.

[4] The EU has had its own General System of Preferences as well as the Lome and Cotonou Agreements with the ACP countries. The General System of Preferences is currently being revised to make it more favourable to very poor countries. As a result of WTO rulings, the EU is also transforming its ACP relationships into regionally based Economic Partnership Agreements with some of the world's poorest countries. Though controversial, Economic Partnership Agreements are probably the best way forward for smaller, weak economies. Regional integration with their close neighbours can help ACP countries move onto a more successful growth path.

Apart from that, the APA should lead to the EU and the US putting together these preferential agreements, as already explained.

A pro-development rules, standards and trade facilitation agenda

Meeting international rules and standards helps countries achieve comparative advantage. Take the example of trade facilitation. Simpler trade procedures help exports by reducing the cost and time of doing business and allow governments of the poorest countries both to save money and increase revenue collection from duties.

Developing countries need the help of the EU and US to implement international rules and meet international standards. Both countries should offer technical assistance and capacity-building in these areas. The EU and US should also review the current rules. The current standards imposed on the acceptability of developing countries' goods in the EU and the US markets might be excessive.

The problem is especially acute with regard to food products and flowers. The cost of compliance with EU and US health and consumer standards for key developing countries' exports such as food and flowers is high. Of course the EU and the US need to protect their citizens' health and well-being. But current standards tend to generate disproportionate side effects. The EU and the US should review their sanitary and phytosanitary standards for food and flowers imports from developing countries. They should also promote greater international regulatory convergence of health and consumer standards for these products.

We must not forget the barriers arising from "rules of origin". These define the proportion of local content required in any goods, before they can obtain quota or tariff-free access. The US and the EU set different rules and their impact can be restrictive. This needs to change. Origin rules must be simplified and harmonized so that the same rules apply to all markets and are easy to use. The EU and the US should agree common rules. The WTO work on global harmonization of origin rules, currently almost blocked, should also bring new results.

A multilateral framework ensuring protection for FDI

The issue of protection for FDI in developing countries frequently appears on the international agenda of institutional cooperation. This is hardly surprising, because the security offered to foreign investments in developing countries is the most important factor in attracting capital to these countries, which need it so badly.

We should recall that there is a not-too-distant precedent for attempts in this direction: the Multilateral Agreement on Investments, designed in the OECD, but which was not implemented.

Protection of investments should be integrated into the negotiation agenda of the WTO as soon as possible. It is one of the most important issues on the Singapore Agenda. The failure of the Cancun negotiations unfortunately pushed this issue into a secondary position. The EU and US should jointly promote the reintroduction of this issue into the current trade negotiations within the WTO.

The problem of developing countries supply-side domestic capacities.

Though insufficient, there is substantial market access in Europe and the US for the poor, but the fundamental point is that without capacity building, the poorest cannot use the preferences they already have. Aspects of EU and US policies are open to legitimate criticism, but it is completely unfair to shift total responsibility onto the EU and the US for denying developing countries access to their markets. The core of the problem lies in supply-side domestic capacities.

In other words, open trade is not a magic wand. Growth and development will only result if the opportunity to trade is combined with the necessary capacities to participate in trade. Trade will not promote development without parallel investment in the supply side.

This means, first of all, building good governance. The EU and the US have top-quality administrations. Developing countries with good governance potential need tangible help with capacity building.

Secondly, countries cannot trade without the necessary investment in infrastructure. Trade is not possible if a country cannot get goods to market at reasonable costs. Lack of properly functioning port facilities is, for example, a major obstacle. Lack of roads and railways is another obvious problem. New resources must be spent on growth-enhancing investments in infrastructure.

Trade cannot thrive without a labour force with basic levels of education and health. The EU and the US should thus maintain their commitments to the UN Millennium Development Goals on human development targets for the world's poor.

In many developing countries, and obviously in poor countries, the investment required to generate trade capacities can only come from external aid, effectively used. That is the reason why more fresh financial resources are needed. The EU and the US are leading extremely important initiatives which have already been launched. We will refer to the Monterrey program and the G8 debt alleviation plan later on.

Let us take the example of the European Union and its "Everything But Arms" initiative[5]. Initiatives of this kind could also be implemented by the US, as well as by the rest of the developed world, in particular, by Japan and Canada.

Trade can thus make a huge contribution to development, once the capacity to participate in the global trading system has been established.

FINANCIAL AID FOR DEVELOPMENT

The Millennium Development Goals

Many people consider the Millennium Development Goals (MDG) insufficient, while others think that they are overly optimistic. At least they

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[5] Three years ago the European Union dramatically extended tariff and quota-free access for all LDCs with its "Everything But Arms" initiative. All LDC products, including all types of agriculture, will enter the EU entirely tariff and quota-free. Though there remain issues about how these preference regimes might be made more effective, Everything But Arms was by any measure a very radical step.

have represented an effort to set out specific quantitative goals for development in the present decade.

The following tables offer a summary of the MDG

A Complete Listing of the Goals, Targets, and Indicators for MDGs

Goals and Targets	Indicators
Goal 1: Eradicate poverty and hunger	
Target 1: Halve, between 1990 and 2015, the proportion of people whose income is less than $1 per day.	1. Proportion of population below $1 (purchasing power parity or PPP) per day. *1a. Poverty headcount ratio (percentage of population below national poverty line). 2. Poverty gap ratio (incidence times depth of poverty). 3. Share of poorest quintile in national consumption.
Target 2: Halve, between 1990 and 2015, the proportion of people who suffer from hunger.	4. Prevalence of underweight in children (under five years of age). 5. Proportion of population below minimum level of dietary energy consumption.
Goal 2: Achieve universal primary education	
Target 3: Ensure that, by 2015, children everywhere (boys and girls alike) will be able to complete a full course of primary schooling.	6. Net enrollment ratio in primary education. 7a. Proportion of pupils starting grade 1 who reach grade 5.[1] *7b. Primary completion rate. 8. Literacy rate of 15–24 year olds.
Goal 3: Promote gender equality and empower women	
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and in all levels of education no later than 2015.	9. Ratio of girls to boys in primary, secondary, and tertiary education. 10. Ratio of literate women to men, ages 15–24. 11. Share of women in wage employment in the nonagricultural sector. 12. Proportion of seats held by women in national parliament.
Goal 4: Reduce child mortality	
Target 5: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.	13. Under-five mortality rate. 14. Infant mortality rate. 15. Proportion of one-year-old children immunized against measles.
Goal 5: Improve maternal health	
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.	16. Maternal mortality ratio. 17. Proportion of births attended by skilled health personnel.
Goal 6: Combat HIV/AIDS, malaria, and other diseases	
Target 7: Halt and begin to reverse the spread of HIV/AIDS by 2015.	18. HIV prevalence among pregnant women, ages 15–24. *19. Condom use rate of the contraceptive prevalence rate.[2] 19a. Condom use at last high-risk sex. *19b. Percentage of 15–24 year olds with comprehensive correct knowledge of HIV/AIDS.[3] 20. Ratio of school attendance of orphans to school attendance of non-orphans, ages 10–14.
Target 8: Halt and begin to reverse the incidence of malaria and other major diseases by 2015.	21. Prevalence and death rates associated with malaria. 22. Proportion of population in malaria-risk areas using effective malaria prevention and treatment measures.[4] 23. Prevalence and death rates associated with tuberculosis. 24. Proportion of tuberculosis cases detected and cured under directly observed treatment short course (DOTS).

A Complete Listing of the Goals, Targets, and Indicators for MDGs (cont.)

Goals and Targets	Indicators
Goal 7: Ensure environmental sustainability	
Target 9: Integrate the principles of sustainable development into country policies and program and reverse the loss of environmental resources.	25. Proportion of land area covered by forest. 26. Ratio of area protected to maintain biological diversity to surface area. 27. Energy use (kilograms of oil equivalent) per $1 GDP (PPP). 28. Carbon dioxide emissions (per capita) and consumption of ozone-depleting chlorofluorocarbons (ODP tons). *29. Proportion of population using solid fuels.
Target 10: Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation.	30. Proportion of population with sustainable access to an improved water source, urban and rural. 31. Proportion of population with access to improved sanitation, urban and rural.
Target 11: Achieve, by 2020, a significant improvement in the lives of at least 100 million slum dwellers.	32. Proportion of households with access to secure housing.
Goal 8: Develop a global partnership for development	
Target 12: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. (This includes a commitment to good governance, development, and poverty reduction—both nationally and internationally.)	*Note: Some of the indicators listed below will be monitored separately for the least developed countries, Africa, landlocked countries, and small island developing states.*
Official Development Assistance (ODA)	
	33. Net ODA total and to the least developed countries, as a percentage of OECD/DAC donors' gross national income.
Target 13: Address the special needs of the least developed countries. (This includes tariff-free and quota-free access for exports, enhanced program of debt relief for heavily indebted poor countries (HIPC), and cancellation of official bilateral debt, and more generous ODA for countries committed to poverty reduction.)	34. Proportion of bilateral, sector-allocable ODA of OECD/DAC donors for basic social services (basic education, primary health care, nutrition, safe water, and sanitation). 35. Proportion of bilateral official development assistance ODA of OECD/DAC donors that is untied. 36. ODA received in landlocked countries as a proportion of their gross national incomes. 37. ODA received in small island developing states as a proportion of their gross national incomes.
Market Access	
Target 14: Address the special needs of landlocked countries and small island developing states (through the Program of Action for the Sustainable Development of Small Island Developing States and 22nd General Assembly provisions).	38. Proportion of total developed country imports (by value and excluding arms) from developing countries and from least developed countries that is admitted free of duty. 39. Average tariffs imposed by developed countries on agricultural products and textiles and clothing from developing countries. 40. Agricultural support estimate for OECD countries as a percentage of their gross domestic product. 41. Proportion of ODA provided to help build trade capacity.
Debt Sustainability	
Target 15: Deal comprehensively with the debt problems of developing countries through national and international measures to make debt sustainable in the long term.	42. Total number of countries that have reached their HIPC decision points and number that have reached their HIPC completion points (cumulative). 43. Debt relief committed under HIPC initiative. 44. Debt service as a percentage of exports of goods and services.

A Complete Listing of the Goals, Targets, and Indicators for MDGs (cont.)

Goals and Targets	Indicators
Other	
Target 16: In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.	45. Unemployment rate of 15–24 year olds, male, female, and total.[5]
Target 17: In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries.	46. Proportion of population with access to affordable, essential drugs on a sustainable basis.
Target 18: In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.	47. Telephone lines and cellular subscribers per 100 population. 48a. Personal computers in use per 100 population. 48b. Internet users per 100 population.

[1] An alternative indicator under development is "primary completion rate."
[2] Among contraceptive methods, only condoms are effective in preventing HIV transmission. Since the condom use rate is only measured among women in union, it is supplemented by an indicator of condom use in high-risk situations (Indicator 19a) and an indicator of HIV/AIDS knowledge (Indicator 19b). Indicator 19c (contraceptive prevalence rate) is also useful in tracking progress in other health, gender, and poverty goals.
[3] This indicator is defined as the percentage of 15–24 year olds who correctly identify the two major ways of preventing the sexual transmission of HIV (using condoms and limiting sex to one faithful, uninfected partner), reject the two most common local misconceptions about HIV transmission, and know that a healthy-looking person can transmit HIV. However, since there are currently not a sufficient number of surveys to be able to calculate the indicator as defined above, UNICEF in collaboration with UNAIDS and WHO have produced two proxy indicators that represent two components of the actual indicator. They are the percentage of women and men ages 15–24 who know that "consistent use of condom" can protect a person against HIV infection and the percentage of women and men ages 15–24 who know that a healthy-looking person can transmit HIV.
[4] Prevention is measured by the percentage of children under age five sleeping under insecticide-treated nets. Treatment is measured by percentage of children under age five who are appropriately treated.
[5] An improved measure of this target is under development by the International Labour Organization.

* These indicators have been proposed as additional MDG indicators, but have not yet been adopted.
Source: The World Bank.

However, the debate hinges on the efficiency of the instruments used for development aid, such as the role of trade, the usefulness of providing new funds and writing off debt, and the role of institutional reforms.

Development funding. The need for a complement to the financial markets.

One of the basic characteristics of any developing economy is its low rate of capitalization. This lack of capital is general, including physical capital (whether public or private), human capital, technological capital and the lack of appropriate institutions.

Many developing economies do not generate enough savings to finance the process of capital accumulation and institutional reform needed to speed up

growth, become fully integrated in the international trade circuit and reduce the number of people living in poverty.

The money sent back home by expatriates and foreign direct investment are both essential sources of finance. Remittances sent home by expatriates are becoming increasingly important as a source of finance from outside. In 1990 these remittances to developing countries were worth 31 billion dollars, and in 2004 they were over 126 billion dollars. What is more, 35% of them went to countries with the lowest incomes. Remittances will continue to grow as emigration flows continue.

Direct foreign investment is the main source of finance for developing countries, and stood at 166 billion dollars in 2004. It is obvious that there is a positive relationship between direct investment and development. Developing countries have to create a suitable environment and a stable regulatory and institutional framework if they want to attract foreign investment and reap these advantages. A recent study by the World Bank[6] has pointed to the main areas that countries should pay attention to if they want to create an economy which attracts foreign investment.

However, the money from all the sources mentioned above is not sufficient. As a result, countries often run up debts on the international financial markets. In fact, these markets supply a large proportion of the capital absorbed by emerging economies, though they are not sufficient on their own to finance development, for a number of reasons:

1. There are countries which do not have access to international credit, either because they do not have a sufficient level of income to guarantee their issues, or because they have lost market confidence after a balance of payments crisis.
2. There are areas of development which do not generate benefits in the short term, or whose benefits are diffuse, and they cannot be financed through international credit.

It is unrealistic to think it possible that poor developing countries alone can solve infrastructure problems such as ports, roads, railways, water and energy

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[6] World Bank (2005).

supplies. The private sector will not get involved in these investments. Poor people simply lack the money to pay user charges. So, in addition to encouraging conditions that attract private investment, new resources are needed.

Thus although new financing and debt relief is not the solution, they cambe a part of the solution.

This is why financial support through Official Development Aid is important, especially for the poorest countries and those projects or sectors which are keys for development, and cannot be financed through the markets.

In recent years the falling trend of ODA in the 1990s has been reversed. According to the OECD Development Aid Committee, development aid rose from 52 billion dollars in 2001 to 68 billion in 2003, and the figure for 2004 is initially estimated at 78 billion. This means an increase of more than 4% a year in real terms. In terms of the GDP of OECD countries, ODA has increased from 0.22% in 2001 to 0.25% in 2004.

The Sachs report for the UN estimated the "funding gap for least-developed countries" (LDCs) to be of the order of 0.3% of OECD GDP[7].

However, improving the quality of the ODA is even more important than increasing its quantity. The Paris Declaration of October 2004 established the need to set up a system to monitor the quality of aid using 12 quantitative indicators for which targets should be established by 2010.

The debate on possible new funding mechanisms

Given the difficulties of fulfilling the ODA commitments, let alone increasing them, a number of proposals have been made for finding additional development finance.

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[21] The Sachs report estimates that "in a typical low-income country with an average per capita income of $300 in 2005, external financing of public interventions will be required of the order of 10-20% of GNP."

Among them are the UNU-WIDER *Study on New Sources of Development Finance (2001);* the *Landau Report (2004)* commissioned by the French President; the *Report of the Technical Group on Innovative Finance Mechanisms (2004)* in which Brazil, France, Chile, Spain and Germany are involved; and the *UK Treasury proposal* (2004) to "frontload" aid to help meet the MDGs by creating an International Finance Facility (IFF).

The proposed mechanisms can be summarised as follows:

The International Finance Facility (IFF)

The donor country pledges money it has already budgeted for a series of years to an international fund linked to a country. The fund can issue bonds with an AAA rating guaranteed on the basis of this aid. Thus the receiving country gets the funds in advance without any extra budgetary effect on the donor country, helping to meet the MDGs more speedily. The cost of receiving the funds immediately is the interest rate of the AAA bond.

In other words, the IFF would enable money to be borrowed at present against repayment of debt in future. This would help frontload the efforts so that "lives can be saved today, rather than action postponed to the indefinite future". Obviously, however, if the money available for aid is not to be reduced in the years ahead, by interest and debt repayments on the IFF bonds, then new sources of revenue for international development have to be found. This is what the G8 agreement in July 2005 is about.

The IFF mechanism is suitable for specific programmes which have already been designed and can make immediate use of resources, as well as having a minimum of return to meet the cost of the finance.

There is already a pilot programme of these characteristics: IFF for immunization, designed to provide funds for child vaccination in Africa.

Unlike the traditional ODA, IFF creates incentives for recipient countries to use the resources efficiently, as they have a small cost. It quickly mobilizes resources which otherwise would not have been available because it does not have an immediate effect on the budgets of donor countries.

However, it is not clear that a pledge to pay for a number of years does not have an effect on the budget (for example, Eurostat has not made a decision on this question).

Apart from this, the governance and decision-making structures of the fund could cause problems with design and implementation.

Global taxes

There have been a large number of proposals for establishing global taxes to finance MDGs. The proposed taxes tend to be on offshore activities which are normally not subject to taxation by national systems, or on profits generated by the use of global collective goods.

1. *Tax on carbon emissions.* The taxable base would be carbon dioxide emissions from hydrocarbon combustion. A tax of $21 per tonne of carbon dioxide would represent revenues of around $130 billion, and an increase of $0.013 per litre of petrol.
2. *"Tobin" tax.* This is a tax on short-term foreign currency transactions. A tax of 0.02% would generate revenues of around $ 30 billion.
3. *General tax on financial transactions.* This would be like a Tobin tax extended to all kinds of financial transactions.
4. *Tax on aviation fuel.* At present this is not taxed because there is no tax coordination. No airport taxes fuel consumption to prevent other airports getting a competitive advantage.
5. *Tax on arms sales.*
6. *Surtax on the profits of multinational companies.* The aim would be to "internalize the consequences of fiscal competition", which are considered to be negative (wrongly in our opinion).
7. *Surcharges on existing taxes.* Surcharges have been suggested to the present rates of VAT or income tax.
8. *Tax on the exploitation of "global commons".* This would involve taxes on the exploitation of common resources such as the sea bed and of the Antarctic, satellite positioning, pollution in the high seas, or fishing in international waters.

The Bretton Woods institutions have carried out an analysis of all these proposals, and drawn up the following table, in which they are classified according to five criteria: revenue adequacy and stability[8], efficiency[9], equity[10], ease of collection[11] and minimum coalition size[12].

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[8] The *revenue adequacy and stability* criterion says that a tax should collect a sufficient amount to make significant progress in financing the MDGs. The revenues depend on the tax base and rate, and these are directly related to the ability to collect revenues and its efficiency. In general, taxes with a very broad base and low rates are preferred, since they are less likely to be evaded and create fewer distortions. According to this criterion, a global tax on coal (60-130 billion), the Tobin tax (30 billion) and the general tax on financial transactions are the taxes with the highest collection capacity. Taxes on aviation fuel, arms sales and maritime pollution would generate far lower revenues.

[9] In terms of the *efficiency* criterion, a tax is efficient if it generates few distortions in the decisions made by economic agents. This happens when the rate is low and/or demand elasticity for the object of the tax is low. The efficiency also increases if the object of the tax are goods or activities which generate negative externalities. The proposals to tax foreign-currency (the Tobin tax) and financial transactions in general are more inefficient. By narrowing the market they increase volatility, rather than reducing it. In addition, they would make access to financial markets by emerging countries more difficult. The tax could also be easily avoided through creative accounting, and it would make effective risk management more difficult. Although the tax is small, in fact it would have a snowball effect which could have an impact on a great number of intermediary transactions, thus multiplying its distorting effect.

The most efficient taxes would be those which counterbalance negative externalities: the tax on carbon emissions (which, however, competes with the emissions rights market created by Kyoto; a choice would have to be made between the Pigou tax and the Coase solution); taxes on international aviation; taxes on common resources; and taxes on arms sales.

[10] The *equity* criterion would mean guaranteeing that rich countries are those which pay most, to ensure effective redistribution. Only the tax on multinationals would theoretically comply with this criterion, although most of the proposals would in practice have a similar level of equity.

[11] The report says that in terms of the *ease of collection* criterion, the proposals have a high correlation between efficiency and ease of collection. In the case of the carbon or aviation fuel tax, they are taxes with similar effects at a country level to special taxes. The object of the tax is clear and the taxpayer finds it very difficult to evade. At the other end of the scale are taxes on financial transactions and multinationals, which are more susceptible to evasion through creative accounting.

[12] The criterion of *minimum coalition size* refers to the number of countries necessary to make the tax effective. If the number of participants is insufficient, there would be a "free rider" effect among non-participating countries, to which economic activity would flow.

Rating innovative tax instruments					
	Revenue ($billion p.a.)	**Efficiency**	**Equity collection**	**Ease of building**	**Coalition**
Carbon	60-130	H	M	H	M
"Tobin" tax	30	L	M	M	M
General financial transactions tax	H	L	M	H	L
International aviation fuel	9	H	M	H	M
Maritime pollution	1	H	M	H	M
Arms sales	2.5-5	H	M	M	M
Global commons	L	H	H	H	H
Surtax on multinational profits	M	M	H	L	L
Surcharges on VAT or income tax	M	L	M	M	H
Voluntary contributions					
Add-ons to routine taxes	L	H	H	H	H
Tax-based measures	L	H	H	M	H
Lotteries etc.	M	H	H	H	H

H = high, M = medium, L = low.

The overall assessment of all these proposals for raising taxes is not positive, for well-founded reasons.

First, because the OECD countries, and in particular most European countries, already have a high tax burden, which creates significant distortions in the economy. Raising the tax burden still further can only increase these distorting effects.

Instead of proposing tax increases, we think it would be preferable to reduce public spending on many items which have been shown to be inefficient (for example, agricultural subsidies and subsidies to public companies), and earmark these resources for increasing official development aid.

Secondly, the argument that taxes should be raised to supposedly increase resources for development aid is largely fallacious, as well as being full of risk. In no developed countries are taxes earmarked for their specific purposes. VAT, for example, is collected and deposited in the public treasury like any other tax, and VAT revenues joins the other taxes in financing public spending as a whole. As a result, there is no legal link between the increase in revenues and a possible increased volume of resources destined for development aid.

It could even happen that greater resources (if indeed they were collected) would end up financing increases in other budgetary items.

Surcharges on taxes earmarked to pay for development should be voluntary, as is the case in the box on the income tax form which may be ticked by the taxpayer who wants a certain proportion of taxes to be earmarked for development.

Voluntary contributions

Contributions for development from individuals, NGOs and private foundations are growing significantly and represent an increasingly stable source of international development aid flows.

Governments can improve the efficiency of the flows of private development finance by a variety of mechanisms, such as tax exemptions or through public-private partnerships for certain projects.

The challenge is to ensure that these flows regularly reach the greatest number of countries, are coordinated within a general framework designed for development aid, and can be absorbed by the recipient countries.

If the problems of ensuring continuity, an even allocation and reasonable volume could be solved, voluntary aid would be the best form of financing development, since it does not generate tax distortions which affect public funds.

Special Drawing Rights (SDRs). The Soros proposal

Under this proposal, the richest countries would donate part of their SDR holdings to a fund which would finance global public goods (for example, AIDS treatment) and other development programmes. It represents a cost for donor countries in the form of the interest rate on the total SDRs they have assigned.

This means that the SDRs are used for a purpose different from that for which they were created, which was to generate international liquidity. A

redistribution of SDRs would not be more than a redistribution of the resources of donor countries to recipient countries, which could be done using other instruments.

Although it is a simple and, in theory, fair plan in terms of the share of the development burden among countries, the donation of SDRs is still ultimately no more than an alternative to a possible increase in taxes, which takes attention away from reducing inefficient public spending. In addition, assigning SDRs to objectives linked to development is not possible under the present Constitutive Convention of the IMF, and the allocation of additional SDRs simply to finance development could leave international liquidity at levels which are inconsistent with the needs of the global economy.

Millennium Challenge Account

This is an instrument established by the United States and based on the Monterrey principles. Under it, the US offers new aid to countries chosen according to three specific criteria: good governance, investment in the population and economic freedom. Until now, 17 countries have been identified as eligible for aid under the account.

This instrument rewards good behaviour and creates incentives for laying the groundwork to promote growth.

GLOBALIZATION, CAPITALISM AND POVERTY REDUCTION

The economy, like other spheres of life, is the subject of a series of opinions which attract popular attention and are enormously attractive to demagogues, but which are totally false. They fall apart as soon a strict analysis is made of their foundations.

One of these ideas is that capitalism, the free market and globalization are the causes of an increase in poverty and global economic inequality. It is not unusual to hear opinions such as the following:

"The dramatic advance of neo-liberal globalization has been accompanied by an explosive growth in inequality and the return of poverty. If we take

the planet as a whole, the 358 richest people in the world have a wealth which is greater than the income of the 45% poorest section of the human race (some 2,600 million people)". Ignacio Ramonet, *Le Monde Diplomatique*, May 1998.

"To the detached observer, noting the contrast between the presumed benefits of globalization and developments in the real world, the international economy displays a number of worrying trends. Most obviously, poverty and inequality have grown alongside the expansion of globalization. In a world of disturbing contrasts, the gap between rich and poor countries, and between rich and poor people, continues to widen." Kevin Wadkins (United Nations Development Programme).

We hear arguments like this every day, since they have been adopted as dogma by leaders of anti-globalization movements. But the most worrying thing is that this completely false idea has also been accepted by influential and important people and institutions, such as the United Nations and the World Bank.

It is really strange to relate globalization and increasing poverty, since the most reliable studies[13] carried out in recent years on this question show precisely the opposite. Poverty increased in the world in the 1960s and 1970s. But starting in 1980, precisely the year which is taken to be the birth of the globalization phenomenon as we know it today, the trend began to be reversed.

It was precisely at the start of the period of "savage capitalist neo-liberal globalization" (as it is known by the extreme left-wing anti-globalization ideologues), precisely when China started its liberalization and introduced market mechanisms into the economy and opened up to the outside world, and precisely when India did the same, that the number of poor people in the world fell from 1,200 million to less than 800 million in the year 2000.

Thus it is a big lie to argue that poverty has increased in the last 25 years. Both the number of poor people and the proportion of the population which is poor have fallen during this time.

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[13] Sala-i-Martín, X. (2005), "The World Distribution of Income", *Quarterly Journal of Economics* (forthcoming).

The argument could be strengthened further if we compare countries which have been successful in cutting poverty, mainly Asian countries, with those which have failed, mainly African. In 1970, around 40% of the Chinese population had a daily income of $1 a day or less. In 1980, under the leadership of Mao, the proportion of poor people was similar, but the rich people in China had improved their position. The rich got richer, and the poor continued to be poor, as is common in communist regimes.

Starting in 1978, market mechanisms were introduced, and the economy opened up to the outside world. Globalization arrived in China. As a result, between 1980 and 1990, poverty fell drastically, and has continued to fall to the present day. It is true that poverty still exists in China, but in 2000 fewer than 4% of the population lived below the poverty line. The gap between rich and poor has increased, but this has not stopped the poor from increasing their income substantially. Overall, poverty has been slashed in China at rates which were never seen before the arrival of globalization.

At the other extreme, among the countries which have remained closed to the globalization phenomenon we have the dramatic case of Nigeria. Nigeria has registered 40 years of negative growth thanks to corrupt governments, but the highest-income 20% are getting increasingly rich (increasing inequality), so that they have no incentives to implement reforms.

Faced by this overwhelming evidence, the enemies of freedom and the market have refined their arguments. They no longer talk only about poverty; they talk about inequality as well. They argue that globalization is also the cause of an increase in economic inequality in the world. This is a different problem, although as it happens, it is not true either. Nobody questions the fact that poverty is a bad thing, and that it should be eradicated. (Though as a matter of fact only the free market and globalization has proved capable of doing so in recent decades).

But is inequality in fact a bad thing? It is clear that this question is much more controversial. If the poorest people in a country increase their income by 15% and the richest by 20%, inequality increases. Is this situation worse than that which existed before, when everyone had lower income levels?

There is room for debate, but it seems reasonable to think that rather than being worse, the opposite is true.

We cannot simply say that inequality is something negative and not give it any more thought. And in fact, since 1980, economic inequality in the world has gradually decreased thanks to globalization and open markets. This is because Asia has begun to open its markets up to the outside world, to grow and to be prosperous. When 1,300 million Chinese and 1,100 million Indians begin to develop economically, a large proportion of the people with the lowest per capita income in the world begin to converge with the income of the most advanced countries. As a result of this process, global inequality, as measured by any index (Gini, Atkinson, etc.) begins to fall.

We thus see that the myth of growing inequality - "The rich are getting richer because the poor are getting poorer" – is just that: a myth. Globalization generates higher income for all, rich and poor, and inequality is being reduced.

It is therefore false to argue that globalization is the cause of poverty in the world, or that there has been an increase in inequality. At present, the great tragedy of extreme poverty is to a large extent limited to Africa, where globalization and the free market economy have yet to arrive. Instead, it suffers from the lingering heritage of communism, and billions of dollars have been spent on ineffective policies, which in many cases have only served to increase the wealth of corrupt governments.

None of the proposals such as the 0.7% target, debt write-offs, or the Tobin tax, are real solutions to the problem of poverty in Africa. The rest of the world did not need any of these to develop. It did so by opening up borders to globalization and the free market.

The US and the EU joint commitment to the Monterrey Programme

The Monterrey Consensus has been the biggest step forward for a long time in terms of joint cooperation for development aid. Monterrey is a landmark which should continue to be a reference for future development policies.

The Monterrey Consensus is an excellent example of what transatlantic cooperation can lead to. This historical achievement was possible thanks to the joint leadership of the US and, in particular, President George W. Bush, and the EU, headed up by the Council President, the Spanish Prime Minister José María Aznar.

The Monterrey Consensus offers the right approach. Despite the name of the conference at which it was drawn up (the International Conference on Financing for Development), the consensus did not only deal with development policies in terms of finance, but also trade, investment, good government and mobilization of the developing countries' own resources.

As well as the G8 agreement of July 2005 which wrote off the debt of a long list of the poorest countries, and which we will refer to below, the EU and US can now jointly advance in applying the Monterrey Consensus to supply additional resources for financing development.

However, we would suggest that these commitments should be subject to each recipient country maintaining balanced policies and offering tangible results.

The G-8 debt alleviation agreement: the Africa Plan

The extreme poverty of hundreds of millions of human beings living in Africa required special and urgent action by the EU and the US. The appalling conditions under which they live, the loss of life to infant mortality and disease, and the misery into which large parts of Africa have sunk, pose a great moral challenge to Europeans and Americans. As Prime Minister Tony Blair made clear, "the state of Africa is a scar on the conscience of the world".

In the last few years, we were able to feel a gathering of international political will. The shock of the Tsunami in Asia made the Western world even more conscious of the pandemics that destroy life in other parts of the world: the 3,000 children a day who die in Africa as a result of malaria, or the 6,000 people a day who die of AIDS.

The first step must be to how to tackle these problems and to identify the tools for development. The most powerful are institutional reforms and trade.

Debt relief and new financial resources are also absolutely necessary to create the basis for sustainable development, but money alone is not enough to ensure lasting development. There must be structural reforms.

The poor countries have to respond with institutional reforms and the elimination of corruption, bad governance, dictatorship and civil war. Trade is the fourth leg of this development structure. Building trade capacity is essential in order to profit from trade opportunities. It requires investment in infrastructures and the development of a labour force with basic levels of education and health. The four pillars of development are inter-connected, because actions on institutional reforms, trade, aid and debt are complementary.

In the field of trade, access to the markets of the EU and the US is crucial, as we have already highlighted.

We have already stressed that growth and development will only result if the opportunity to trade is combined with the necessary capacity to participate in trade. Trade will not promote development without parallel investment in the supply side. This is particularly true for many African countries, and this is where new funding fits.

It is unrealistic to think that it is possible for these countries alone to solve infrastructure problems with ports, roads, railways, water and energy supplies. The private sector will not get involved in these investments, as poor people simply lack the money to pay user charges. So in addition to encouraging conditions that attract private investment, we need to design public/private partnerships to ensure that developing countries can make use of private sector skills, with a key role being played by investment funded by overseas aid.

In 2004, the UK Government launched a new initiative called the new International Financing Facility (IFF). It would enable money to be borrowed now against repayment of debt in the future. This would help frontload the efforts so that lives can be saved today, rather than action postponed to the indefinite future. Obviously, however, if the money available for aid is not to be reduced in the years ahead by interest and debt repayments on the IFF bonds,

then new sources of revenue for international development have to be found. This is what the G8 agreement is about.

In July 2005, the G8 leaders gathered the will to act in favour of the poorest. Once again, joint EU and US leadership (British Prime Minister Tony Blair and EU Commission President José Manuel Barroso for the EU and US President George W. Bush) reached an historic agreement to alleviate poverty through debt cancellation for a long list of African countries.

In spite of its weak points, the G8 agreement on debt cancellation on 7 July 2005 was an historic decision in this field. However, there are serious risks that it will generate negative collateral effects[14].

Cooperation in other multilateral fora

The EU and the US should also commit themselves to cooperation on economic issues dealt with in the OECD, UN institutions, the World Customs Organization and global security fora.

[14] See Thomas Dichter (2005), "*Time to Stop Fooling Ourselves about Foreign Aid. A Ptracticioner"s View'*, Foreign Policy Briefing, CATO Institute, September 12.

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ABBREVIATIONS

APA: Atlantic Prosperity Area
CAFTA-DR: US-Central America and Dominican Republic Free Trade Agreement
EU: European Union
ECB: European Central Bank
FDI: foreign direct investment
GATT: General Agreement on Tariffs and Trade
GATS: General Agreement on Trade of Services
GTAP: Global Trade Analysis Project
IMF: International Monetary Fund
MFN: Most Favanred Nation
MDG: Millenium Development Goals
NAFTA: North America Free Trade Agreement
NTA: New Transatlantic Agenda
TABD: TransAtlantic Business Dialogue
TEP: Transatlantic Economic Partnership
TPN: Transatlantic Policy Network
US: United States of America
WB: the World Bank
WTO: World Trade Organization

ANNEX

INSTRUMENTS OF DIALOGUE BETWEEN THE EU[1] AND THE UNITED STATES.

Type of meeting	Interlocutors	Frequency
Dialogues derived from Summit declarations (1990 Transatlantic Declaration; 1995 New Transatlantic Agenda (NTA); 1998 Transatlantic Economic Partnership (TEP))		
Summit		1/ year (TAD: 2/year)
Ministerial meeting	European Commission (Pres, CION, HR) US State Department	2/year
Ministerial meeting	European Commission (Pres, CION, HR) US State Department	1/year in margins of UNGA
NTA Senior Level Group meeting	European Commission (RELEX) US State Department	4 to 6/year
NTA Task Force meeting	European Commission (RELEX) US State Department	6 to 8/year
TEP steering group	European Commission (TRADE) US Trade Representative	Variable

[1] EU Community dialogue.

High Level consultations		
Policy Dialogue on Border and Transport security	European Commission (JAI, RELEX, TREN) US: Department of Homeland Security, Department of Justice,	2/year
High Level Consultations on Fisheries	State Department European Commission (FISH) US Department of Commerce (National Oceanic and Atmospheric Administration)	1/year, normally in July
High Level Consultations on the Environment	European Commission (ENV) US: Department of State (Office of Ocean and International Environmental Affairs), Environmental Protection	Convened regularly until May 2000, dormant since then
High Level Consultations on Employment and Labour- related issues	Agency European Commission (EMPL) US Department of Labor (Bureau of International Labor Affairs)	1/year
Informal Financial Markets Regulatory dialogue	European Commission (MARKT) US: Treasury, Securities and Exchange Commission	Variable
High Level Consultations on Energy	European Commission (TREN) US: Department of Energy, State Department	1/year, dormant since 2002

High Level Meeting on the enforcement of competition laws	European Commission (COMP) US: Department of Justice, Federal Trade Commission	1/year
Meetings derived from bilateral agreements		
Information Society dialogue	European Commission (INFSO) US: Federal Communication Commission, Department of Commerce, Trade Representative	1/ year
Joint Committee on higher education and vocational training (expiring end 2005)	European Commission (EAC) US Department of Education, Fund for the Improvement of Postsecondary Education	Every 2 years (next meeting mid 2005)
Joint Customs Cooperation Committee	European Commission (TAXUD) US Department for Homeland Security (Customs and Border Protection)	At least 2/ year
Joint Consultative Group on scientific and technological cooperation (expiring 2009)	European Commission (RTD) US State Department	1/ year (did not meet recently due to renewal of the agreement)
Joint Management Committee of the Veterinary Agreement	European Commission (SANCO) US Department of Agriculture (Foreign Agricultural Service)	1/ year (met in 2001, 2002 and 2003)

Joint Committee and Joint Technical Working Group under the Agreement for Cooperation in the Peaceful Uses of Nuclear Energy between the European Atomic Energy Community and the United States of America	European Commission (TREN) US: Department of State (Office of Nuclear Energy Affairs), Department of Energy (National Nuclear Security Administration)	1/year

Type of meeting	**US Interlocutors**	**Frequency**
Working groups on the implementation of the agreement on the promotion and use of Galileo and GPS satellite-based navigation systems and related applications	European Commission (TREN) US: State Department, Department of Defence, Department of Transport (GPS Joint Programme Office), Department of Homeland Security, NASA	1- 2/year (each of the 4 working groups)
Transport Security working group	European Commission (TREN) US Department of Homeland Security (Transportation Security Administration and Coast Guard)	Approx. every 9 months
Technical Commission on the implementation of the Agreement on the Co-ordination of Energy Efficient Labelling Programmes for Office Equipment	European Commission (TREN) US Environmental Protection Agency	1/year several ad-hoc technical meetings/year

Meetings derived from voluntary commitments		
Horizontal and sectoral dialogues under the voluntary Guidelines on Regulatory Cooperation and Transparency covering the regulation of goods (except agriculture)	European Commission (ENTR) US: Trade Representative; other Regulators as appropriate (e.g. FDA, DOC, EPA)	Min. 1/year at Director General level; Various horizontal and sectoral meetings/year

EU-US AGREEMENTS[2]

	Name of agreement	Date of conclusion	Date of entry into force
1.	Exchange of letters on the method of EU-US cooperation in environmental matters	1974.07.01	
2.	Arrangement between the European Economic Community and the Government of the United States of America concerning trade in steel pipes and tube	1989.11.20	
3.	Arrangement between the European Coal and Steel Community and the European Economic Community and the Government of the United States of America concerning certain steel products	1989.11.20	
4.	Agreement between the European Communities and the Government of the United States of America regarding the application of their competition laws	1991.09.23	1991.09.23
5.	Agreement between the European Economic Community and the Government of the United States of America concerning the application of the GATT Agreement on trade in large civil aircraft	1992.07.17	
6.	Agreement in the form of an exchange of letters between the European Community and the United States of America on government procurement	1993.05.25	1993.05.25

[2] Source: European Council's Secretariat data base and European Comission http://ue.eu.int/cms3_fo/showPage.asp?id=252&lang=fr&mode=g

7.	Agreement in the form of an Exchange of Letters between the European Community and the United States of America on the mutual recognition of certain distilled spirits/spirit drinks	1994.03.15	1994.03.15
8.	Agreement in the form of an Exchange of Letters between the European Economic Community and the United States America concerning the application of the Community Third	1994.07.01	
	Country Directive, Council Directive 72/462/EEC, and the corresponding United States of America regulatory requirements with respect to trade in fresh bovine and porcine meat		
9.	Agreement between the European Atomic Energy Community, represented by the Commission of the European Communities and the United States Department of Energy in the field of Nuclear Material Safeguards research and development	1995.01.06	
10.	Agreement between the European Community and the United States of America renewing a programme of co-operation in higher education and vocational education and training; renewed for another 5 year period	1995.12.21 2000.12.18	1996.01.01
11.	Agreement in the from of a Memorandum of Understanding between the Department of Labour and the EC on the implementation of the EU-US Action Plan in the field of employment.	1996.05.02	

12.	Agreement for the conclusion of the negotiations between the European Community and the United States of America under Article XXIV:6 + Exchange of Letters between the European Community and the United States of America concerning an agreement on cereals and rice + Exchange of Letters between the European Community and the United States of America concerning the price of rice	1996.07.22	1996.07.22
13.	Agreement for cooperation in the peaceful uses of nuclear energy between the European Atomic Energy Community and the United States of America, Official Journal L 120, p. 0001 – 0036, 20 May 1996	1996.04.12	
14.	Exchange of Letters recording the common understanding on the principles of international cooperation in research and development activities in the domain of Intelligent Manufacturing Systems between the European Community and the United States of America, Japan, Australia, Canada and the EFTA countries of Norway and Switzerland	1997.04.03	1997.04.03

	Title of agreement	Date of conclusion	Date of entry into force
15.	Agreement between the European Community and the United States of America on precursors and chemical substances frequently used in the illicit manufacture of narcotic drugs or psychotropic substances	1997.05.28	1997.07.01
16.	Agreement between the European Community and the United States of America on Customs Cooperation and Mutual Assistance in Customs Matters Expanded by the Agreement between the European Community and the United States of America on intensifying and broadening the Agreement on customs co-operation and mutual assistance in customs matters to include co-operation on container security and related matters	1997.05.28 2004.04.22	1997.08.01 2004.04.22
17.	Agreement in the form of a Memorandum of Understanding between the European Community and the United States of America on Spirituous Beverages	1997.10.03	1997.10.03
18.	Agreement for scientific and technological cooperation between the European Community and the Government of the United States of America (renewed by exchange of notes verbales for another 5 year period as of 08 October 2004)	1997.12.05	1998.10.14
19.	International Agreement in the form of an Agreed Minute between the European Community and the United States of America on humane trapping standards	1997.12.18	

20.	Agreement on Mutual Recognition between the European Community and the United States of America	1998.05.18	1998.12.01
21.	Agreement between the European Communities and the Government of the United States of America on the application of positive comity principles in the enforcement of their competition laws	1998.06.04	1998.06.04
22.	Agreement between the European Community and the United States of America on sanitary measures to protect public and animal health in trade in live animals and animal products	1999.07.20	1999.08.01
23.	Technical Exchange and Cooperation Arrangement between the United States Nuclear Regulatory Commission (USNRC) and the European Atomic Energy Community (Euratom) represented by the Commission of the European Communities in the Field of Nuclear Safety Research	1999.10.29	
24.	Agreement between the United States of America and the European Community on the Coordination of Energy Efficient Labelling Programmes for Office Equipment	2000.12.19	2001.06.07
25.	Exchange of Letters recording the common understanding reached on the accession of the Republic of Korea to the common understanding on the principles of international cooperation on research and development activities in the domain of intelligent manufacturing systems between the	2001.12.20	

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26.	Agreement in the form of an Exchange of Letters between the European Community and the United States of America relating to the modification of concessions with respect to cereals provided for in EC schedule CXL to the GATT 1994	2002.12.27	2002.12.27
27.	Technical Exchange and Cooperation Arrangement between the Department of Energy of the United States of America and the European Atomic Energy Community as represented by the Commission of the European Communities in the Field of Nuclear Related Technology Research and Development	2003.03.06	
28.	Agreement between the European Union and the United States of America on Extradition	2003.06.25	
29.	Agreement on Mutual Legal Assistance between the European Union and the United States of America	2003.06.25	
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31.	Agreement between the European Community and the United States of America on intensifying and broadening the Agreement on customs cooperation and mutual assistance in customs matters to include cooperation on Container Security and related matters	2004.04.22	2004.04.22

32.	Agreement between the European Community and the United States of America on the processing and transfer of PNR data by Air Carriers to the United States Department of Homeland Security, Bureau of Customs and Border Protection	2004.05.28	2004.05.28
33.	Agreement on the promotion and use of Galileo and GPS satellite-based navigation systems and related applications	2004.06.26	

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