EUROPEAN UNION

TRADE SUMMARY

The European Union (EU) and the United States share the largest two-way trade and investment relationship in the world. The U.S. trade deficit with the European Union was $82.4 billion in 2002, an increase of $21.1 billion from 2001. U.S. goods exports in 2002 were $143.7 billion, down 9.5 percent from the previous year. Corresponding U.S. imports from the European Union were $226.1 billion, up 2.8 percent.

U.S. exports of private commercial services (i.e., excluding military and government) to the European Union were $86.1 billion in 2001 (latest data available), and U.S. imports were $65.8 billion. Sales of services in the European Union by majority U.S.-owned affiliates were $194.0 billion in 2000 (latest data available), while sales of services in the United States by majority European Union-owned firms were $200.7 billion.

The stock of U.S. foreign direct investment (FDI) in the European Union in 2001 was $640.8 billion, up from $604.4 billion in 2000. U.S. FDI in the European Union is concentrated largely in finance, manufacturing and services sectors.

IMPORT POLICIES

Market Access Restrictions for U.S. Steel

In March 2002, the EU adopted a provisional safeguard on 15 steel products. The measure consisted of tariff-rate quotas (TRQ), which were to be filled on a "first come, first served" basis. Imports exceeding the TRQ were subjected to additional tariffs between 14.9 percent and 26 percent. The EU took this provisional safeguard action without conducting a fact-finding investigation to first determine whether any injury had been caused by imports. The United States requested formal World Trade Organization (WTO) consultations with the EU in May to discuss U.S. concerns that the EU's procedures violated the terms of the WTO Safeguard Agreement. The consultations did not resolve U.S. concerns and in August, the United States requested the establishment of a WTO dispute panel. The panel was established in September and is expected to render its decision in spring 2003.

In September, 2002, the EU completed a fact-finding investigation and determined that injury had been caused with respect to seven of the 15 steel products subject to the provisional safeguard: non-alloy hot rolled coils, non-alloy hot rolled sheets and plates, non-alloy hot rolled narrow strip, alloy hot rolled flat products, cold rolled sheets, fittings and flanges. The EU subsequently replaced its provisional safeguard with a definitive safeguard measure on these seven steel products, taking effect on September 29, 2002. As with the earlier safeguard, the EU's final safeguard consists of TRQs that will be filled on a "first come, first served" basis. Imports exceeding the TRQs will be subjected to additional tariffs between 17.5 percent and 26 percent. The EU also established an import surveillance system with the possibility of rapid future safeguard action on 14 additional steel products.

Restrictions Affecting U.S. Wine Exports

Since the mid-1980s, U.S. wines have been permitted entry to the EU market through temporary exemptions from EU wine-making regulations. These regulations require wines imported into the EU to be produced with only those oenological practices (wine making practices) that are authorized for the production of EU wines. Without these “derogations” for U.S. wine-making practices, many U.S. wines would be immediately barred from entering the EU. In addition, U.S. wines that are produced with practices for which there is no EU derogation are barred already. By contrast, U.S. law effectively grants automatic acceptance of EU wine-making practices absent a health or safety concern. The current derogation that has been extended to the United States expires on December 31, 2003.

U.S.-EU negotiations on a bilateral wine agreement were launched in 1999 and continued throughout 2002. The United States continues to be concerned about the EU's requirements for import certification and the review and approval of future wine-making practices, and has sought reductions in the EU's export subsidies and subsidies to its grape growers and wine producers. The U.S. Government also has proposed that the EU and the United States adopt a joint position on wine tariffs in the WTO agriculture negotiations. The United States will continue to press the EU in the negotiations to give U.S. wine makers

equitable access to the EU wine market.

The use of certain names and terms on wine labels also remains unresolved. The EU is seeking a U.S. commitment to phase out the usage in the United States of semi-generic names (e.g., burgundy, champagne, chablis) on labels of non-EU wines. The United States has indicated its willingness to negotiate on this issue within the U.S. regulatory framework for wine labeling. However, the United States has also expressed an interest in obtaining labeling protection for its wine names in the EU.

On April 29, 2002, the EU adopted a new wine labeling regulation (Commission Regulation No. 753/2002), which was scheduled to enter into force on January 1, 2003. The United States, along with a number of other WTO Members, had serious concerns about its lack of clarity and, more importantly, about its WTO-consistency, and submitted written comments outlining these concerns and urging withdrawal of the regulation. Specifically, the regulation appears more trade restrictive than necessary to meet any legitimate objective, as it would prohibit the presentation on imported wine of information important for the marketing of wine unless certain conditions are met (e.g., a geographical indication must also appear on the label or the terms used must be regulated in the producing country). In addition, the EU imposes restrictions on the use of "traditional terms" listed in the regulation, in some instances granting exclusive use of a term to an EU wine in a manner akin to intellectual property. Traditional terms are, for the most part, terms used with certain other expressions (often geographical indications) to describe wine or liqueur, and in many cases the terms are generic (e.g., "ruby" and "tawny"). The United States does not recognize the concept of traditional terms as a form of intellectual property, nor is this subject covered under the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS).

The EU, in November 2002, postponed implementation of the new wine labeling regulation until August 1, 2003, but it is unclear whether it plans to address WTO Member concerns. The United States will continue to seek resolution of the issues raised by this new regulation.

U.S. concerns related to EU geographical indications for (non-wine) agricultural products are covered below (see section on Intellectual Property Rights Protection).

Customs Administration Procedures

Individual EU Member States have their own customs procedures. Substantive approaches to valuation and tariff classification can vary from Member State to Member State, with disparate treatment prevailing unless and until a harmonization of practice can be achieved through Member State committee-like consultations and agreement – rather than through timely action undertaken by a centralized authority. Further examples of variance by Member States include disparities in certificate of origin requirements, treatment of express shipments, and the use of automation for border procedures. Increasingly, U.S. exporters have expressed concern about a lack of uniformity in treatment resulting from this situation, which fosters unpredictability and can result in barriers to trade. This problem is compounded by the absence of EU tribunals and procedures that would provide for the prompt review and correction of administrative actions relating to customs matters, as is required by Article X:3(b) of the GATT 1994. Review by the European Court of Justice of national decisions regarding customs administrative matters may be available in some cases, but generally only after a review is conducted at the national level. Obtaining corrections with EU-wide effect for administrative actions relating to customs matters may take years.

The lack of access for traders to prompt review and correction by a tribunal with EU-wide jurisdiction is not a new phenomenon. However, the concern it has engendered is heightened by the anticipated enlargement of the EU to include ten new Members. Also relevant to this concern is the mandate in the Doha Declaration (paragraph 27) for WTO Members to commence negotiations on trade facilitation at the Fifth Session of the WTO Ministerial Conference later this year. Ensuring that opportunities for U.S. exporters are enhanced through improved customs administration procedures and practices within the EU will be important as the work under the Doha mandate advances.

Market Access Restrictions for U.S. Pharmaceuticals

U.S. pharmaceutical companies encounter consistent market access problems throughout the EU due to the price, volume, and access controls placed on medicines by national governments. The pharmaceutical industry views these controls as undermining the value of patents, distorting competition among medicines and across national markets, limiting access by patients' to innovative products, and diminishing the contribution of Europeans to research and development.

While the EU's single market ensures that pharmaceuticals, like other goods, can move freely across borders among EU Member States, Member States' public health authorities impose their own strict price controls on pharmaceuticals. As controlled prices vary greatly from one Member State to another, intermediaries engage in parallel trade (profiting at pharmaceutical companies' expense by buying drugs in countries where the price is lower and selling them in Member States where the price is set at a higher level). This practice undermines the ability of pharmaceutical companies to set prices for their products and recoup their research and development costs.

Another impediment stems from the EU policy of testing at the point-of-entry each batch of pharmaceuticals imported from the United States for quality. The testing obligation is a costly and time-consuming one, which not only delays market access, but also increases market costs, and therefore places U.S.-based pharmaceutical manufacturers at a competitive disadvantage.

The proposed Future Medicines Legislation is still under review. At time of this writing, the proposal would create a centralized European agency for the evaluation of medicinal products and would also affect data protection - two issues which if mismanaged, could affect market access.

Austria: A pharmaceutical firm seeking to include a product on the list of reimbursable drugs in Austria must first obtain the approval of the umbrella organization of social insurance funds (Hauptverband/HVB). The approval is needed in order to provide consumers with immediate access to products. Pharmaceuticals not approved for reimbursement have higher out-of-pocket costs. According to many U.S. and European pharmaceutical companies, the HVB approval process (particularly the long delay in securing HVB decisions) limits market access for innovative pharmaceutical products. They also complain that the problem is compounded by other (often relatively quick) HVB approvals of generic competitor products even before patents for the innovative products have expired. U.S. companies operating in Austria reported cumulative losses between $25 million and $100 million due to these practices.

In November 2001, the European Court of Justice decided that Austria's approval process does not conform to the EU Transparency Directive. Following the judgment, Austria revised some aspects of the approval process in 2002. However, innovative U.S. and other pharmaceutical companies cite continued problems. The United States and Austria are discussing this issue under bilateral Informal Commercial Exchange (ICE) talks, with a view to speedier and more transparent approvals.

Belgium: There have been significant delays in providing approval of pricing and reimbursement for new pharmaceutical products. In response to pressure from industry and the U.S. Embassy, the Belgian Government implemented in the spring of 2002 legislation that would conform Belgian practice to relevant EU directives. According to American industry, delays in reimbursement and pricing decisions have decreased. U.S. pharmaceutical companies are disproportionately affected by these procedural delays as they are among the leaders in Belgium in developing and bringing to market innovative new products. Pharmaceuticals in Belgium are also under strict price controls. There is a price freeze on reimbursable products and required price reductions on drugs on the market for 15 years. A three percent turnover tax is charged on all sales of pharmaceutical products, and a mechanism exists by which pharmaceutical companies are obligated to reimburse to the government 65 percent of the overages in pharmaceutical spending. Control of prices for reimbursed and non-reimbursed products affect not only in-country sales, but export sales to third-country markets for which the Belgian price is the reference price. According to industry sources, Belgian prices fall between 10 percent to15 percent below average European prices. More generally, the U.S. pharmaceutical industry considers the Belgian situation regarding pharmaceuticals to be non-

compliant with the very concept and structure of the European internal market.

Denmark: The Danish government has failed to provide reimbursement for new innovative medicines or has delayed reimbursement for long periods. Within the context of the Danish socialized health system, this has the practical effect of preventing the sale and use of such medicines. The government and the pharmaceutical industry now have in place a voluntary price agreement which was implemented following a government-imposed price reduction and freeze in November 2000. If the ban were lifted, U.S. exports would increase by less than $10 million based on current export levels, according to U.S. industry. However, not all of the medicines affected by the policy are produced in the United States. Thus, an additional benefit of an improved reimbursement policy would be higher revenue to subsidiaries of U.S. firms.

France: The government that assumed office in 2002 has taken steps that could lead to adoption by France of a fast track approval process and prices for the most innovative drugs more comparable to those in other European markets. At present, however, France's health care provisions are still based on a December 1997 law. This imposes strict limits on health expenditures, particularly in the area of pharmaceuticals, and allows the French government to exact rebates from companies for sales exceeding an established limit and imposes a levy on pharmaceutical companies that is designed to finance social security budget overruns. Under the 2002 Social Security funding law, the "national health spending target" has been set at 110.3 billion euros – an increase of 3.8 percent on estimated spending for 2001. Half of health care overspending in 2001 was due to drug expenditures. This led the government to develop a drug policy for 2002 focused on developing the use of generics and cutting certain medications, such as those deemed to be "low-performance."

Germany: As part of broader health care cost-cutting efforts, the German government in late 2002 announced plans to mandate a 6 percent reduction in the reimbursement prices for patented medicines. This measure was approved by the German parliament. The government, having abolished reference pricing for medicines in the mid-1990s, sought in late 2002 to reintroduce it. At year-end, parliamentary approval of this measure remained uncertain. U.S. pharmaceutical firms regard these measures as discriminatory, in that they disproportionately affect sales of innovative drugs produced by U.S. companies.

Italy: In 2001, the Government of Italy began a series of reforms to control health care expenditures, which stemmed in part from the elimination of patient co-payments for pharmaceuticals. The government transferred responsibility for health care expenditures from the central to regional governments, with the central government capping overall health care expenditures, and limiting reimbursements for pharmaceuticals to 13 percent of the overall budget. In April 2002, a government decree temporarily reduced pharmaceutical reimbursements by five percent across the board. Italy's 2003 financial law not only makes this reduction permanent, it increases the cuts by an additional 1percent to 2 percent. U.S. companies question the fairness of the government's cost-efficacy formula to determine reimbursement levels.

U.S. pharmaceutical companies are concerned that the devolution of marketing approval authority to regional governments, in addition to the Ministries of Health and Economy, will cause unwarranted delays in bringing new products to market. These added costs, plus lingering concerns about price controls, call into question whether U.S. companies can continue to operate in Italy, where many have substantial investments in research and development as well as production.

The Netherlands: U.S. companies have complained that the criteria used by the Dutch health insurance board (CVZ) too often result in their new-to-market products being incorrectly classified with drugs determined by the board as "therapeutically equivalent" (and therefore reimbursable at a lower rate) rather than as "unique, innovative drugs," which are reimbursed at a higher international reference price. They have also voiced concerns that the Dutch health insurance board procedures have resulted in considerable and unnecessary delays in classifying products for reimbursement.

The Dutch health insurance board (CVZ) evaluates new pharmaceuticals and decides whether these should be classified in Annex 1A

of the reimbursement system or whether these are eligible for placement in Annex 1B. Reimbursement listing 1A allows reimbursement of a product to an amount maximized by the mean price of a cluster of therapeutically equivalent medicines. Reimbursement listing 1B allows full reimbursement at prices maximized by the pharmaceutical price act, an international price reference system enforced by law. Admittance to listing 1B is only granted to unique, innovative products, which cannot be clustered with therapeutically equivalent compounds.

Spain: Pharmaceuticals and drugs must go through an approval and registration process with the Ministry of Health lasting several years unless previously registered in an EU Member State or with the London-based EU pharmaceutical agency, in which case the process is shortened to a few months. Regardless of registration process, real access to the Spanish market is often delayed due to lengthy administrative pricing plus reimbursement procedures. In July 2002, in a move likely designed to cut health expenditures, the Spanish Ministry of Health approved a regulation requiring that consumers obtain special approval from a state inspector in order to allow pharmacies to fill prescriptions for two drugs produced by U.S. pharmaceutical manufacturers. Adoption of the measure has resulted in sharply decreased sales for both drugs. Many U.S. pharmaceuticals sold in Spain are still protected under the former pharmaceutical process patent regime. U.S. pharmaceutical manufacturers assert that effective patent protection for these drugs is limited because Spanish health authorities too easily comply with requests to produce copy drugs.

STANDARDS, TESTING, LABELING AND CERTIFICATION

As traditional trade barriers affecting transatlantic trade and investment have declined in recent years, specific trade obstacles arising from unnecessary divergences of U.S. and EU regulations and the lack of transparency in the EU rulemaking and standardization processes have loomed relatively larger in importance. While U.S. and EU regulatory authorities often share similar regulatory objectives, differences in our respective regulatory policies and procedures can have significant implications for U.S. trade interests. Compliance with unnecessarily divergent regulations and related standards for products sold in both markets imposes additional costs on U.S. companies (e.g., product redesign, duplicative testing) and increases time required to bring a product to market. Such compliance costs are compounded by the inadequate transparency of the EU rulemaking system and a lack of meaningful opportunity for non-EU stakeholders to provide input on draft EU regulations and standardization activities. To address these systemic concerns, the United States continues to promote greater U.S.-EU regulatory cooperation and enhanced transparency in the EU regulatory system.

Standardization

Given the large volume of U.S.-EU trade, EU standardization work in regulated market segments is of considerable importance to U.S. exporters. Although there has been some progress with respect to the EU's implementation of legislation, a number of problems related to this evolving EU-wide legislative environment continue to impede U.S. exports. These include: delays in the development of EU standards; delays in the drafting of harmonized legislation; inconsistent application and interpretation by EU Member States of legislation; overlap among Directives dealing with specific product areas; gray areas between the scope of various Directives; and, in some cases, reliance on design-based, rather than performance-based, standards. In addition, there are concerns related to the respective procedures, responsibilities (e.g., accountability, redress) and transparency in both the Commission and the European standards bodies that require careful monitoring and more frequent advocacy efforts. The following two examples illustrate the type of standards-related problems affecting U.S. exporters.

Gas Connector Hose Standard: The European Standardization organization, CEN, is in the process of drafting a standard for gas connector hoses, which is likely to exclude a U.S. product from the market because of design specifications. The U.S. manufacturer has experienced considerable difficulties in gaining access to the standardization process, and has been unsuccessful in countering assertions by the CEN Technical Committee that only fixed/welded connections can be considered safe methods for gas hose connectors. This

almost ten-year-old case represents the most long-standing example of the market access barriers that European standards can create. Both U.S. industry and the U.S. Government have argued in favor of performance-based standards for years, and the U.S. Government has persistently raised this case with national CEN members and Commission officials to press for more transparency and performance criteria in the CEN standardization process.

Pressure Equipment Directive: In May 2002, the EU Pressure Equipment Directive (PED) entered into force, imposing new requirements on manufacturers of such equipment. Previously, pressure equipment manufacturers could demonstrate conformity based on standards for material specifications, including the U.S. ASME Code. Manufacturers using the ASME Code are now uncertain about continued EU market access, as the European standards incorporate material specifications slightly different from those found in the ASME Code. In the absence of a full set of harmonized EU standards (only one has been approved to date), the PED permits manufacturers to file for an EAM (European Approval of Materials); however, no requests for EAMs have been approved so far. Another option, the Particular Material Appraisal (PMA), is not yet a functioning alternative, as the administrative procedure still needs to be established. In light of these factors, U.S. manufacturers question the need for the re-testing of products, and seek the "grandfathering" of existing materials.

Biotechnology

The EU's four and a half year *de facto* moratorium on the approval of new products of modern biotechnology has hindered U.S. exports of corn and threatens exports of soya. Food processors and exporters are either reformulating or seeking non-bioengineered sources, and the likelihood of new mandatory traceability and labeling requirements is causing enormous uncertainty in the food, feed, and seed sectors. Problems exist for both approved products and products currently seeking approval. Biotechnology continues to be more of a political than a scientific issue in Europe and prospects for improvement remain dim.

With some minor exceptions, no biotechnology products have been approved since 1998. Several products have been under review for more than six years, as compared with an average 6-9 month process in Canada, Japan, and the United States. U.S. exports of corn to Spain and Portugal, the most significant EU importers, have almost stopped.

Several Member States including Austria, Luxembourg and Italy have imposed marketing bans on some biotechnology products despite existing EU approvals. The European Commission has not taken steps to overturn the bans, despite the fact that the EU's Scientific Committee has found no justification for the bans. Portugal and Germany have suspended approvals for planting certain biotechnology products.

Directive 01/18, governing approval of biotechnology products, including seeds and grains, for environmental release and commercialization was implemented in October 2002. However, EU Member States have refused to lift the approvals moratorium despite the new, more stringent legislation and say they are waiting for proposed traceability and labeling rules to come into force.

In July 2001, the European Commission submitted for approval by the Council of Ministers and the European Parliament two proposals for new rules governing traceability and labeling and, biotechnology food and feed authorizations. The proposals include mandatory traceability and labeling requirements for all biotechnology products and downstream products that would be onerous and expensive for producers and foreign suppliers to meet. As of December 2002, the European Council had reached a political agreement on the proposed food and feed and traceability and labeling directives. The proposed directives must still go through the Parliament before final adoption by the Council. If adopted, the proposals will not come into force for at least six months.

Austria: Austria has imposed a marketing ban on some biotechnology products despite existing EU approvals. Under current Austrian rules, unapproved biotechnology events must not be detected in conventional seeds ("zero tolerance"), but EU-approved events may be present in conventional and organic seeds up to 0.1 percent. This standard is more restrictive than what is commonly accepted practice in the EU.

France: There are six bioengineered products approved for sale in France (Bt 176 corn, Bt 11 corn, MON 810 corn, T25 corn, Roundup Ready soybeans, and ITB-1000-0X tobacco). However, no bioengineered crops are grown in France other than for research purposes. On July 4, 2002, the French Ministry of Agriculture approved eight applications for open-field testing of bioengineered crops, but none of them could be planted in 2002. The number of bioengineered test plots, mainly corn, is 41.

Greece: Recently, Greece has not been responsive to applications to introduce bioengineered seeds for field tests, despite support for such tests by Greek farmers and Greece's agricultural science community.

Italy: There are varying positions on agricultural biotechnology among Italy's Ministries of Health, Agriculture, and Environment. The Ministry of Agriculture is trying to minimize the risk of adventitious presence contamination by imposing extremely rigorous thresholds for seed purity, which threaten U.S. exports of conventional corn and soybean seed. The stated objective of the Ministry of Agriculture is to disallow any bioengineered presence in seeds. In the case of soybeans used for animal feed, the Ministry of Agriculture tacitly allows biotechnology, since it is unable to segregate in storage or in processing the locally produced non-bioengineered soybeans from those of imported origins. Italy has not rescinded its ban on four EU-approved bioengineered corn varieties (BT11, MON 810, MON 809 and T25) which was enacted by the previous government.

Ban on Beef from Cattle Treated with Growth Promoting Hormones

For more than fourteen years, the EU has banned imports of beef from cattle raised with hormonal growth promoters. The United States launched a formal WTO dispute settlement procedure in May 1996 challenging the EU ban. The WTO ruled that the EU's ban is inconsistent with the WTO Agreement on Sanitary and Phytosanitary (SPS) measures because it is imposed without a risk assessment based on scientific evidence of health risks, and in 1999 the WTO authorized the United States to impose sanctions on EU products with an annual trade value of $116.8 million.

In December 2002, the EU permanently banned the use of estradiol-17-ß, a growth promoter widely used in the United States and which has been determined by the U.S. Food and Drug Administration (FDA) to pose no health risk to consumers. The EU also presented a number of studies that analyzed the use of hormones in beef production, though none of these studies presented any new evidence to support the EU's hormone ban.

The United States and the EU continue to explore possible resolutions to this dispute.

Poultry Regulations

U.S. poultry exports to the EU have been banned since April 1, 1997 because U.S. poultry producers currently use washes of low-concentration chlorine as an antimicrobial treatment (AMT) to reduce the level of pathogens in poultry meat production and meet strict U.S. safety standards, a practice not permitted by the EU sanitary regime. In October 1998, the EU published a study on AMTs recommending that such treatments could be used as part of an overall strategy for pathogen control throughout the production chain. Although some forms of treatment such as tri-sodium phosphate (TSP) and lactic acid were deemed more acceptable, the use of chlorinated water was rejected by the study.

In 2002, the United States continued to work with the EU to address differences between U.S. and EU food safety rules for poultry with a view toward restoring U.S. poultry exports to the EU and preserving existing markets for U.S. poultry in Central and East European countries that are moving to adopt EU standards in this area. As part of this effort, the United States has provided the European Commission with four detailed scientific reports on proposed compounds for EU approval as alternative AMTs. Additionally, the United States has provided a point-by-point response to a 1997 EU audit of U.S. poultry meat production facilities and detailed information regarding the U.S. residue control program and the EU's additional residue testing program. Both sides have committed to finding an appropriate resolution by the June 2003 U.S.-EU Summit.

France: According to a 1961 decree of the Ministry of Agriculture, poultry originating from countries which allow the use of compounds incorporating arsenic in poultry

feed, cannot enter France for human use. As the United States does not ban these products, this decree creates a *de facto* ban on U.S. poultry meat for human consumption in France.

Animal By-Products Legislation

In October 2002, the European Commission approved legislation (1774/2002) that requires that animal by-products not intended for human consumption, including blood products, hides, and pet food, be derived from the carcasses of animals deemed fit for human consumption. In February 2001, the U.S. had commented on this regulation when it was first notified to the WTO by the European Union as a proposal. The U.S. concerns notified to the WTO included the lack of an adequate basis to identify a hazard, no proper assessment of risk, and no scientific justification of the measures proposed to mitigate the risk. Unfortunately, the final regulation that was approved was even more rigid and sweeping than the one originally notified. In addition, many of the details are still unclear or are being worked out internally despite a May 2003 implementation date.

In early February 2003, USDA Secretary Veneman sent a letter to EU Commissioner Byrne stating that Regulation 1774/2002 creates onerous and scientifically unjustified new restrictions on U.S. exports of hides, skins, gel bones, pet food, gelatin, and other products. The Secretary also noted a lack of transparency in the regulations. The Secretary asked for a delay in the implementation of the regulation until these issues can be addressed; as of mid-March, the EU has not yet responded.

The proposed legislation was initially developed in response to the BSE crisis but has been broadened to address several additional animal and public health issues. The Animal Waste Directive replaces Directive 90/667/EEC on the disposal and processing of animal waste and amends Directive 90/425/EEC. This regulation, as currently written, will negatively impact U.S. exports of animal by-products not intended for human consumption to the European Union, valued at $525 million. The legislation prohibits the use of any rendered protein which was obtained from animal carcasses that were unfit for human consumption as an animal feed ingredient or for pet food. For example, fallen stock will not be permitted in feed.

Transmissible Spongiform Encephalopathies (TSE) Regulations

Under a 1997 directive (Directive 97/534/EC), the EU prohibited the use of so-called Specified Risk Materials (SRM's). The goal of the ban was to avoid health risks related to transmissible spongiform encephalopathies (TSEs), such as bovine spongiform encephalopathy (BSE), which is linked to a new variant of Creutzfeldt-Jakob disease in humans. The ban prohibited the use of SRMs (defined as the skull, tonsils, ileum and spinal cord of cattle, sheep and goats aged more than one year, and the spleens of sheep and goats) in any products sold in the EU. In September 1999, this directive was implemented with regard to SRMs in medical products for human use. Thus far, it appears U.S. companies have successfully complied with this element of the SRM ban.

In June 2000 a Commission Decision was adopted, repealing the previous Commission Decision, but setting new requirements for handling SRMs. This new measure limited the scope of the ban to food, feed and fertilizer and required slaughterhouses and authorized meat cutting and processing plants in all EU Member States, regardless of whether BSE exists in a particular country, to remove the SRMs mentioned above. The measure became effective October 1, 2000 for all EU Member States.

Initially the ban did not apply to third countries. However in March 2001, the EU published the results of their geographical BSE risk (GBR) assessment of third countries exporting food, feed or fertilizer products to the EU. In order to establish their risk status, Commission recommendation 98/477 invited third countries and Member States to submit a complete dossier on their epidemiological status with respect to BSE. On the basis of the U.S. dossier, the Scientific Steering Committee (SSC) concluded that it is still unlikely, but cannot be excluded, that BSE is present in the United States. This put the United States in category II of GBR (Geographical BSE Risk).

In late May 2001, the European Commission adopted a Regulation, which is eventually intended to supersede all existing TSE legislation. Among other things, it establishes criteria to classify the BSE status of Member

States and third countries into one of five classification categories. Certain requirements, including removal of SRM's, would then be applied to a country depending on the classification.

Under the current Regulation of transitional measures passed in July 2001, only countries recognized as provisionally BSE-free (GBR-1) are not required to remove SRM's in order to export to the EU. The United States, as a GBR category II country, is required to remove SRM's and mechanically-recovered meat (MRM) from animal products exported to the EU, causing significant disruption for U.S. exporters. Under the EU's new classification procedures, the United States fully expects to be placed a category where removal of SRM's would not be required.

In July 2002, the Standing Committee on Animal Health and the Food Chain approved the lifting of restrictions on the trade of embryos and ova. This decision followed the Scientific Steering Committee's opinion on the safety of bovine embryos.

France: A Ministerial order of 12 April 2002 relating to the ban on importing certain ruminant tissue for human consumption due to Transmissible Spongiform Encephalopathies (TSEs) requires a certificate for import into France of animal products, stating compliance with EU regulation 999/2001 modified by regulation 270/2002/EEC. For products derived from ovine, caprine, and bovine that are not born, bred and slaughtered in the BSE-free countries listed in the regulation, a French certificate including a longer list of specified risk materials (SRMs) must be added to the EU certificate.

Gelatin Regulation

In October 1999, the EU adopted a Directive that established requirements, effective June 1, 2000, for manufacturing facilities producing gelatin for human consumption. Under the directive, manufacturing facilities are required to meet certain procedures for authorization and registration, inspection and hygiene, as well as control measures. Also covered are the raw materials permitted and the treatments they must undergo before being used in the manufacture of gelatin. The EU has stated that the U.S. regulations for gelatin are equivalent under the U.S.-EU Veterinary Equivalency Agreement, except for residue testing and inspection of tanneries. Therefore, the United States has, on numerous occasions, proposed wording on the health certificate to address those requirements that are not deemed equivalent. The EU has continually rejected the U.S. proposed language, erecting new barriers by insisting on different language on the health certificate. The result has been a ban on U.S. exports since June 2000. The U.S. provided the EU with proposed new language for the health certificate in December 2002 and is waiting for a response.

Triple Superphosphate Fertilizer

EU legislation (EC Directive 76/116) requires Triple Superphosphate (TSP) – a phosphate-based fertilizer used to enhance soil fertility and to increase crop yields – to meet a standard of 93 percent water solubility in order to be marketed as "EC-Type" fertilizer. Scientific studies done to date on typical crops cultivated in Europe show that water solubility rates of 90 percent or higher are not necessary to gain the agronomic benefits associated with adding TSP to the soil. While in theory, TSP of any origin can be imported and sold in the EU, the inability to market TSP with less than 93 percent water solubility as "EC-Type" restricts its marketability, depresses its price, and has the effect of unfairly discriminating against countries that cannot meet the 93 percent water solubility requirement. EU imports of "non-EC-Type" TSP have been virtually eliminated. The U.S. fertilizer industry, which accounts for 20 percent of total world TSP exports, has been working with the European Commission and European industry to amend the water solubility requirements to reflect current scientific and agronomic studies. The United States continues to seek from the European Commission a justification for the 93 percent standard in light of scientific evidence and trade rules.

Emerging Concerns

In addition to the foregoing current trade barriers arising from EU policies regarding standards, testing, labeling, and certification, the United States has serious concerns about the ongoing development of new regulations that would appear to have serious negative consequences for U.S. exporters in the future. The United States is actively engaging the

European Union with respect to the issues outlined below.

Chemicals: The European Commission is now working on a massive overhaul of existing EU policy for chemicals regulation. In its February 2001 White Paper on a "Strategy for a Future Chemicals Policy," the Commission proposed a new, EU-wide regulatory framework called "REACH" (Registration, Evaluation, and Authorization of Chemicals) applicable to all existing and new chemicals. Under this proposed system, chemical companies and downstream users would be responsible for testing chemicals, carrying out risk assessments, and making this information available to a central database run by the European Chemicals Bureau. At this point, it is not clear how polymers, intermediate chemicals, and the end product are to be treated. Virtually every industrial sector, from automobiles to textiles, could be impacted by the new policy.

While the United States fully supports the EU's objectives to protect human health and the environment and acknowledges the need for more information on chemicals, there are concerns that the new policy could have significant adverse trade implications for U.S. products. The EU's White Paper outlines what appears to be a costly, burdensome, and complex regulatory system, which could prove unworkable in its implementation. U.S. industry has warned that the system could present obstacles to trade and innovation, possibly distorting global markets for thousands of products. Industry concerns have also focused on possible bans for some chemicals based on the EU's "precautionary principle." The U.S. chemical industry estimates that the new policy could cost $8 billion for testing and evaluation of chemicals.

The European Council and Parliament have endorsed the Commission's White Paper. The Commission is currently drafting formal legislative proposals, which it expects to issue in June 2003. The U.S. Government has promoted early cooperative engagement with the EU. It has urged the European Commission to give serious consideration to the constructive input from the U.S. Government and from other stakeholders. The U.S. Government continues to underscore the importance of transparency, openness, and accountability throughout the regulatory process as this will contribute to balanced, more effective regulation in the end.

Cosmetics and Animal Testing: In November 2002, the EU approved several amendments to Council Directive 76/768/EEC governing the manufacture and sale of cosmetic products in the European Union. One of the amendments of particular concern to the U. S. government is the ban on the sale in the EU of cosmetics tested on animals. This ban will take effect as soon as there is a validated alternative to animal testing for the cosmetic product/ingredient and, in any event, not later than 2009 for 11 of 14 tests and not later than 2013 for three of 14 tests. This ban could conflict with FDA rules requiring animal testing of certain cosmetics (e.g., anti-dandruff shampoos, sunscreens, fluoride toothpaste) that are classified in the United States as over-the-counter (OTC) drugs for purposes of establishing product safety. The U.S. Government has expressed concern that the entry into force of the ban could restrict transatlantic trade as certain U.S. products tested on animals could be prohibited from sale in the EU, while EU products not tested on animals could be prohibited for sale in the United States. To minimize trade disruption, the U.S. Government and European Commission have agreed to pursue a project on harmonized alternative (non-animal) testing methods. The project will involve cooperation between the U.S. interagency expert group (ICCVAM) and the EU export group (ECVAM). The aim will be to develop mutually acceptable alternatives to animal testing that would then be submitted to the OECD for international validation. This should result in internationally validated alternatives, which FDA could accept for most cosmetics. However, this would not resolve the trade issues regarding cosmetics classified as OTC drugs, since U.S. law requires animal testing to prove the safety of these products.

Waste Management: In June 2000, the European Commission issued proposals for a Directive focusing on the "take back" and recycling of discarded equipment (known as Waste from Electrical and Electronic Equipment or "WEEE"), and a second Directive addressing restrictions on the use of certain substances in electrical and electronic equipment, such as lead, mercury, cadmium, and certain flame retardants (known as Restrictions on the Use of Hazardous Substances or "RoHS"). Under the Conciliation Committee between the European Parliament and the Council, a "common

position" on both directives was reached on October 11, 2002. Under this compromise, producers will be held individually responsible for the waste arising from their new products. The policy is intended to create an incentive for companies to design more environment-friendly products, and will make each manufacturer legally and financially responsible for the recycling of the products that it puts onto the market.

The United States supports the directives' objectives to reduce waste and the environmental impact of discarded products. However, the United States has expressed concerns that the directives lacked transparency in their development and would adversely affect trade in products where viable alternatives may not exist. The directives will, in part, ban certain materials as of July 1, 2006 (mercury, lead, cadmium, hexavalent chromium and the brominated flame retardants PBDE and PBB) and impose comprehensive collection and recycling requirements for end-of-life equipment on a retroactive basis. Responding to concerns about the basis for the substance bans, the Commission has pledged to conduct risk assessments before 2004.

On a related issue, the Commission continues to work on a proposal for a Directive on Batteries that would, in part, ban the sale of nickel-cadmium batteries and products powered by such batteries. The U.S. Government has urged the Commission to conduct a proper risk assessment and seriously consider the battery industries' proposed comprehensive collection and recycling of batteries as an alternative to a ban. In early 2003, the Commission initiated an "extended impact assessment" on its proposed batteries directive. The United States continues to closely monitor these proposals as they proceed through the EU legislative process to ensure that they will not unreasonably restrict trade.

Electrical and Electronic End Use Equipment (EUE): In fall 2002, the European Commission issued a new draft Directive referred to as "EuE" (end-user equipment), which combines the essence of earlier proposals on product design of electrical and electronic equipment to minimize environmental harm, and energy efficiency. The stated objective of the new draft is to minimize harmful effects on the environment. It would be issued as a "new approach" Directive, consisting of a framework and "implementing measures" according to product groups. A formal proposal is expected in 2003. As with its precursors industry is most concerned about the need for product life cycle analysis, fearing adverse impacts on design flexibility, new product development and introduction, and increased administrative burdens.

Acceleration of the Phase-outs of Ozone-depleting Substances and Greenhouse Gases: In June 2000, the EU adopted Regulation 2037/2000, a new Regulation for phasing-out all ozone depleting substances in the EU. The timetable in the directive is faster than that agreed under the Montreal Protocol. The U.S. Government actively opposed early drafts, which proposed phase-outs of HCFCs by 2001 without yielding appreciable environmental benefits. The existing Regulation required the air-conditioning industry to phase out its use of HCFCs by 2001 while most other HCFC uses may continue until 2004. Small (100 kW) fixed air conditioners and heat pump units have been exempted from the initial phase-out.

The European Commission introduced its Climate Change Program in 2001 and is expected to issue approximately 10 new directives in order to implement the program. The Commission's annual progress report on greenhouse emissions assesses the actual and projected progress of Member States toward fulfilling their emission commitments under the UN Framework Convention on Climate Change and the Kyoto Protocol. Available data show that by 2010, EC emissions will have decreased by 4.7 percent, leaving a gap of 3.3 percent to the Kyoto target. Consequently, most Member States are in the process of planning additional policies to limit emissions. The U.S. business community will monitor Commission and Member State activity closely and carefully examine new directives for the impacts on business.

Additional Information on Member State Practices

Some EU Member States have their own national practices regarding standards, testing, labeling, and certification. A brief discussion of the additional national practices of concern to the United States follows:

Austria: Austria became the second EU nation after Denmark to ban a range of uses of the

three fluorinated gases (F-gases) controlled under the Kyoto protocol on climate change. Under an ordinance that took effect on November 22, 2002, hydrofluorocarbons (HFCs) perfluorocarbons (PFCs) and sulphur hexafluoride (SF6) will be prohibited from use in new sprays, solvents and fire extinguishers beginning in mid-2003. Their use in foams will be phased out between mid-2003 and the end of 2007. Use in new refrigeration and air-conditioning equipment will also be banned by the end of 2007. The proposed ban appears to exempt production of HFCs for the export market. Serious objections, which were raised by the European Commission (EC) and some Member States, forced the government of Austria to re-draft and lessen the proposal, particularly with regard to export exemptions. The result will be examined by the EC again. The United States hopes that the Austrian government will consider alternate policy responses.

Denmark: On July 2, 2002, the Danish Environment Minister signed into effect a ban of HFCs, PFCs and SF6, with the first phase-out dates being January 1, 2006 (although new products using these chemicals in tires, spray cans and district heating pipes are not allowed after September 1, 2002). The ban covers the import, use, and sale, but does not cover HFCs for the export market. There are numerous exemptions provided, the most notable being cooling systems with between 150g and 10kg of HFC gas, mobile refrigeration units, vehicle air-conditioning units and vaccine coolers. According to U.S. industry, if the ban were lifted, U.S. exports would increase by less than $10 million based on current export levels and exemptions in the ban. However, the existence of the ban could stimulate similar initiatives in larger European markets.

The Danish Environment and Energy Minister in November 2000 signed an Executive Order banning (as of December 1, 2000) the import and marketing (but not export) of certain products containing lead over the next four years. The ban is at odds with the EU Scientific Committee on Toxicity, Ecotoxicity and the Environment (CSTEE) report on lead that concluded that there are no scientific grounds for the Danish ban. Products for which viable alternatives do not exist, for example car batteries, are not affected by the ban. U.S. industry estimates that if the ban were lifted, U.S. exports would increase by less than $10 million based on current export levels.

Finland: A ban on the importation and sale of new appliances containing HCFC was imposed on January 1, 2000 and remains in place. The importation of the chemical HCFC is allowed when used for maintenance of old appliances using HCFC. New HCFC compounds used for maintenance of refrigeration equipment will be banned as of 2010 and use of all HCFC compounds, including recycled compounds, will be banned as of 2015.

France: National standards impose restrictions on the import of U.S. products in several areas, including enriched flour, bovine genetics, and exotic meats. French regulations prohibit the import of any products made with flour enriched with vitamins, since added vitamins are permitted only in dietetic food products. Current French government marketing controls and regulations restrict trade in bovine semen and embryos. Prior to import, a license must be obtained from the French Customs service and approved by the Ministry of Agriculture. Imports of exotic meats are prohibited by the French government unless authorized by a special waiver. Imports of alligator meat are the subject of ongoing discussions with the French Veterinary Service.

Germany: In late 2002, the German Environment Ministry submitted a proposal for public consideration regarding reduction and eventual elimination (over 10 years or more) of HFCs, PFCs and SF6s. The proposal is in early stages of review within the German government. A meeting involving the Economic Ministry, Environment Ministry, non-governmental groups and industry representatives was planned for late 2002 or early 2003 to discuss the proposal. The Environment Ministry foresees a first draft of proposed regulations to be delivered midway through 2003.

GOVERNMENT PROCUREMENT

Discrimination in the Utilities Sector

In an effort to open government procurement markets within the EU, the EU in 1990 adopted a Utilities Directive covering purchases in the water, transportation, energy and telecommunications sectors. The Directive, which went into effect in January 1993, requires open, objective bidding procedures (a benefit for U.S. firms) but discriminates against

bids with less than 50 percent EU content which are not covered by an international or bilateral agreement. The Directive's discriminatory provisions were waived for the heavy electrical sector in a Memorandum of Understanding (MOU) between the United States and the EU, signed in May 1993. The European Commission has proposed new legislation that would waive the restrictions on telecommunications services, although the restrictions will remain in place until the new Directives would be approved.

On April 15, 1994, the United States and the EU concluded a procurement agreement that expanded upon the 1993 MOU. The 1994 agreement extended nondiscriminatory treatment to more than $100 billion of procurement on each side, including a wide range of sub-central governments. Much of the 1994 agreement is implemented through the WTO Government Procurement Agreement, which took effect on January 1, 1996. The 1994 agreement, however, did not end the discrimination with respect to telecommunications procurement.

The current Utilities Directive specifies that, at such time as there is effective competition in the EU telecommunications services market, purchasing entities will no longer be bound by its detailed provisions. The European Commission's view, elaborated in a Communication issued in May 1999 and in the seventh report on the implementation of EU telecommunications regulations, is that sufficient competition does now exist in all EU Member States. As a result, the Commission published "for information only" a list of telecommunications services in the 12 EU Member States at that time to be excluded from the scope of a revised Utilities Directive. Various telecommunications services, including voice telephony, telex, mobile telephone, paging, and satellite services, will be excluded from the scope of the Utilities Directive that is to be revised. Preliminary research suggests that the affected telecommunications operators are altering their procurement behavior as they are no longer obliged to follow the Utilities Directive. The Commission plans to release an additional Communication soon expanding the exemptions to the Utilities Directive for telecommunications services to all 15 EU Member States. Since 2001, the European Council and Parliament have been reviewing the proposed reforms of the procurement legislation that includes a formal exemption of the entire telecommunications sector from the Utilities Directive. These new Directives are not expected to be implemented before 2005.

Member State Practices

Several EU Member States have their own national practices regarding government procurement. A brief discussion of some of the national practices of particular concern to the United States follows:

Austria: Austria's Federal Procurement Law was amended in January 1997 to bring it into conformity with EU guidelines, particularly on services. U.S. firms nonetheless continue to report a strong pro-EU bias, often even a bias for purely "Austrian solutions," in government contract awards and some privatization decisions. In defense contracts, offset agreements up to 200 percent are common practice. In Austria's largest military procurement ever, the $2 billion purchase of fighter jets in 2002, the U.S. Government and its private sector partner competed jointly under a Foreign Military Sales program. The procurement process in this case raised concerns with regard to transparency. During this competition, Ministry of Defense (MOD) officials are believed to have used one European competitor's capabilities as the basis for some of the Austrian requirements; and MOD officials adhered to design, rather than functional, requirements in an effort to disqualify the U.S. competitor from the competition. Within parts of the MOD, the bias against a U.S. fighter solution was apparent. In the end, the Austrian government selected a European model, which is still in the prototype phase and was the most expensive of the three models in the final selection, but for which the supplier is reported to have offered 200 percent offsets. However, the Austrian government has not yet signed the contract.

France: A U.S. software company alleges that French government agencies have refused to renew contracts with the firm because of the management's relationship to the Church of Scientology. The United States has raised this matter with French government officials.

Germany: In September 1998, the German Ministry of Economics promulgated a "protection clause" that would have prohibited firms from bidding on certain German government contracts if they have employees

that attend or participate in, among other things, Scientology seminars. The United States expressed concern in bilateral consultations about the clause's potentially discriminatory effects on government procurement. In response, the German government revised its "protection clause" and no longer prohibits firms from competing for government contracts on the basis of the affiliation of its management or employees with the Church of Scientology. The Administration will continue to monitor the implementation of the revised policy to ensure that U.S. firms and workers are not discriminated against in German government procurement.

Greece: U.S. suppliers of defense material and services express concern that firms from other EU Member States are favored over U.S. firms in competitions for procurement contracts. U.S. firms that compete jointly with EU partner firms believe they are more likely to win contracts in defense procurement. Greece continues to insist on offset agreements as a condition for the purchase of defense items.

Ireland: Some U.S. companies competing for government contracts have expressed concern about procurement practices in Ireland. One recent case involved the cancellation of a contract to a U.S. firm by Ireland's defense department. The cancellation followed cuts in the defense budget and a challenge by a European competitor to the awarding of the contract in Irish courts. Some unsuccessful U.S. bidders in Irish government procurements have indicated that they are unable to get debriefings on their unsuccessful bids by the contracting agencies, contrary to Irish procurement guidelines. Several U.S. companies have questioned the transparency of some awards, alleging that unqualified companies have won bids over much more qualified firms.

Italy: Italy's fragmented and often non-transparent government procurement practices have, at times, created obstacles to U.S. firms' participation in Italian government procurement. Italy has made progress in making its procurement laws and regulations more transparent and has updated its government procurement code to implement EU Directives. The pressure to reduce government expenditures while increasing efficiency has resulted in increased use of competitive procurement procedures and somewhat greater emphasis on obtaining the best value in its procurement. Italy has recently been more receptive to the U.S. Government's suggestion that some government tender practices have tended to disadvantage market entrants lacking the capacity to bundle services to parallel those offered by incumbents. Italy recently enacted a new public works procurement law aimed at streamlining the bureaucracy related to major infrastructure works and their completion.

EXPORT SUBSIDIES

Government Support for Airbus

The Airbus Integrated Company – a partnership of the French-German-Spanish European Aeronautic, Defense, and Space Company (EADS-80 percent equity share) and the UK's BAE Systems (20 percent equity share) – is the second largest aerospace company in the world. With about half the new aircraft sales worldwide over the last few years, Airbus is a mature company that should face the same commercial risks as its global competitors.

Since the inception of Airbus in 1967, the governments of France, Germany, Spain and the UK have provided direct subsidies to their respective Airbus member companies to aid in the development, production and marketing of Airbus civil aircraft. Airbus member governments have borne a large portion of the development costs for all Airbus aircraft models and provided other forms of support, including equity infusions, debt forgiveness, debt rollovers and marketing assistance, including political and economic pressure on purchasing governments. The United States therefore is concerned about the prospect for further subsidization of Airbus by EU Member States governments. Any distortions caused by illegal subsidies would only exacerbate an already difficult situation for the large civil aircraft industry, which is facing significant losses in the wake of the terrorist attacks of September 11, 2001 as well as a cyclical down turn of the economy.

In 2001, the EU announced that seven of the nine EU Member State governments that have companies participating in the Airbus A380 superjumbo airliner project have committed a total of $3.1 billion to Airbus for the development of the aircraft, the total cost of which is estimated to be $12 billion. France has committed to provide 1.213 billion Euro in

reimbursable advances. The German government has committed to provide 1 billion euro in loans. The British government announced a commitment of 530 million pounds to underwrite BAE System's participation in the project. The repayment terms and interest rates for these loans are not expected to be equivalent to those available from private lenders. The loan repayment obligations are to be success dependent, which means they are repayable only through royalties on aircraft sold, and at interest rates that do not reflect the commercial risks involved.

In addition, the city of Hamburg is spending some 750 million euro to lengthen the runway and expand the facilities for Airbus at the EADS Hamburg-Finkenwerder airport to accommodate the expansion of EADS Airbus assembly there, including that of the A380. French national and local authorities plan to provide 46 million euro ($45.8 million) in aid for road expansion and facility construction for Airbus in Toulouse. These government funds appear to constitute production support for the manufacture of the A380. Furthermore, the EU's aeronautics research programs are driven significantly by a policy intended to enhance the international competitiveness of the European civil aeronautics industry. Through these research programs, the EC and many of the Airbus member governments have provided additional funding worth billions of dollars to support the development of Airbus aircraft programs, including the A380.

European officials claim that Member State support is in compliance with the 1992 U.S.-EU Agreement on Large Civil Aircraft. However, the United States believes that government support to Airbus raises serious concerns about the Member States' adherence to their bilateral and multilateral obligations, including the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). The United States has urged the Airbus member governments to ensure that the terms and conditions of their A380 support are consistent with commercial terms, reflecting both their international obligations and the fact that Airbus is now a highly competitive global producer of aircraft. The United States also believes increased transparency regarding government support to large civil aircraft manufacturing will contribute to better understanding and could foster greater cooperation in the aerospace industry.

Government Support for Airbus Suppliers

Belgium: The Government of Belgium and Belgian regional authorities subsidize Belgian aircraft component manufacturers (operating as the Belairbus/Flabel consortium), which supply parts to the Airbus Integrated Company. In November 2000, the Belgian federal government reached an agreement with the three regional governments responsible for aviation research and development on a Euro 195 million ($195 million) package for the development and prefinancing of components for the new Airbus A380. Since then, Belairbus has already received orders worth $1.3 billion for the A380 from Airbus. Although the regional governments of Wallonia, Flanders and Brussels are usually responsible for industrial assistance, this authority has been ceded to the national level for the A 380 project. There is concern that these subsidies may be in violation of the U.S.-EU 1992 Agreement on Trade in Large Civil Aircraft and/or the WTO subsidies agreement. The Government of Belgium states that they have discontinued an earlier Belgian exchange rate subsidy program which appeared to be similar to a foreign exchange rate guarantee program provided by the German government for its Airbus partner company and its suppliers.

France: In addition to the 1.213 billion Euro in reimbursable advances for development of the Airbus A380 super-jumbo aircraft, the Government of France will provide an additional 59 million Euros ($58.8 million) in reimbursable advances to other aero-structure companies, which have concluded partnership agreements with Airbus for development of the airframe. Further, the government-owned French engine manufacturer SNECMA will receive 102 million Euros ($101.6 million) in support under a royalty-based system authorized by the European Commission for SNECMA's development work on a family of large engines, including its participation in the Engine Alliance (a joint venture between General Electric Aircraft Engines and Pratt and Whitney). The French Government states that this support for engine development is not covered by the U.S.-EU 1992 Agreement on Trade in Large Civil Aircraft.

Government Support for Aircraft Engines

United Kingdom: In February 2001, the United Kingdom announced its intention to provide up to 250 million pounds to Rolls-Royce to support development of two additional engine models for large civil aircraft, the Trent 600 and 900. The UK characterized this engine development aid as an "investment" that would provide a "real rate of return" from future sales of the engines.

Since 1988, the UK Government has committed 949 million pounds to direct product development of Rolls-Royce civil aircraft engines. Despite Rolls-Royce's substantial market share during this period, the UK Government has been repaid only 314 million pounds. This amount would not appear to cover the cumulative interest expense on equivalent commercial debt over the period, let alone provide a return on the loan's principal.

Nonetheless, on October 30, 2001, the European Commission announced its approval of the new 250 million pounds "reimbursable advance" without opening a formal investigation. According to the European Commission's brief press release, the "advance will be reimbursed by Rolls-Royce to the U.K. government in case of success of the program, based on a levy on engine deliveries and maintenance and support activity." Detailed terms of the approved launch aid have not been made public.

As the United States noted in last year's NTE report, continuing UK government support of Rolls-Royce raises serious concerns about UK and EU adherence to the WTO subsidies Agreement. U.S. engine suppliers have lost sales of engines and claim that they have encountered suppressed prices in the United States and world markets.

The European Commission recently made available its final written decision on the UK's Rolls-Royce aid. The United States is analyzing both the decision and the effect of the aid on the market for large civil aircraft engines.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The EU and its Member States support strong protection for intellectual property rights (IPR), and they regularly join with the United States in encouraging other countries to adhere to and fully enforce such IPR standards as those covered by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). However, there are a few Member States with whom the United States has raised concerns either through Special 301 or WTO Dispute Settlement procedures about failure to fully implement the TRIPS Agreement. The United States continues to be engaged with the EU and individual Member States on these matters.

Copyrights

In April 2001, the EU adopted a Directive establishing pan-EU rules on copyright and related rights in the information society. The Directive was the result of more than three years of debate and work by the Commission, the European Parliament and the Council.

The Directive is meant to provide a secure environment for cross-border trade in copyright-protected goods and services, and to facilitate the development of electronic commerce in the field of new and multimedia products and services. It harmonizes the rights of reproduction, distribution, communication to the public and the legal protection of anti-copying devices. The Directive includes a mandatory exception for technical copies on the Internet for network operators in certain circumstances; an exhaustive list of exceptions to copyright which includes private copying (all of the exemptions are optional to the Member States); the harmonization of the concept of fair compensation for rightsholders; and a mechanism to secure the benefit for users for certain exceptions where anti-copying devices are in place.

Designs

The EU adopted a Regulation introducing a single Community system for the protection of designs in December 2001. The Regulation provides for two types of design protection, directly applicable in each EU Member State: the "registered Community design" and the "unregistered Community design." Under the registered Community design system, holders of eligible designs can use an inexpensive procedure to register them with the EU's Office for Harmonization in the Internal Market (OHIM), based in Alicante, Spain. They will then be granted exclusive rights to use the designs anywhere in the EU for up to twenty-

five years. Unregistered Community designs that meet the Regulation's requirements are automatically protected for three years from the date of disclosure of the design to the public. It will be possible to register Community designs with OHIM beginning in 2003.

Patents

Patent filing and maintenance fees in the EU and its Member States are significantly more expensive than in other countries. Fees associated with the filing, issuance and maintenance of a patent over its life far exceed those in the United States.

European Community Patent: U.S. business and industry are largely in favor of the proposed European Community (EC) patent. Once issued, an EC patent would be valid in all EU Member States without additional costly translations. In addition, a special EU court would be established with jurisdiction to decide patent infringement cases, extending legal consistency on patent rulings throughout the EU. While progress has been made on several aspects of the EC patent, significant work remains on issues such as inter-institutional arrangements, use of Member State resources, finances, and the language(s) to be used in filings. Most U.S. businesses also support EC efforts to launch a proposal for an EC software patent.

Patenting of Biotechnological Inventions

On June 16, 1998, after years of debate, the EU adopted a Directive (98/44) on the legal protection of biotechnological inventions. The Directive harmonizes EU Member State rules on patent protection for biotechnological inventions. Member States were required to bring their national laws into compliance with the Directive by July 30, 2000. Some Member States have not yet fully met that obligation. In addition, the Directive is not binding on the European Patent Office.

Austria: Austria is one of a number of EU Member States that have yet to implement the EU Directive. There is considerable resistance to the Directive on legal protection of biotechnological inventions. The Austrian Parliament has deferred action on legislation to implement the Directive despite growing pressure from the biotechnology sector to implement it.

France: France has not yet brought its national law into compliance with Directive 98/44. The French seed industry is asking that the Directive be changed so that plant breeders could be authorized to use protected varieties to conduct their research. The French seed industry prefers to use Plant Variety Rights rather than the patent system. The Plant Variety Rights system, described and defended by the International Convention of 1991 of the Union for Selected Plant Protection, signed by 60 countries, allows varieties protected under the system to be freely used for research and selection of other varieties. This is not possible with the patent system, in which use of a patent-protected variety to create another plant is regulated.

Trademarks

Registration of trademarks with the European Union's Office for Harmonization in the Internal Market (OHIM) began in 1996. OHIM issues a single Community trademark that is valid in all 15 EU Member States.

Madrid Protocol: The World Intellectual Property Organization (WIPO) Madrid Protocol, negotiated in 1989, provides for an international trademark registration system permitting trademark owners to register in member countries by filing a standardized application. EU accession to the Protocol is hampered by Spanish objections, but Member States in favor of accession hope to persuade Spain to drop its opposition.

Geographical Indications: The EU's system for the protection of geographical indications, namely Community Regulation 1493/99 for wines and spirits and 2081/92 for other agricultural products, is not available to other WTO Members on a national treatment basis, requiring instead, particularly with respect to non-wine and spirit products, a specific bilateral agreement. Under the terms of the TRIPS Agreement, the EU is obligated to make such special protection available to all WTO Members, without the requirement for concluding a special agreement. In addition, both regulations appear to deprive trademark owners of TRIPS-level ownership rights by requiring the phase-out of marks that conflict with later-in-time geographical indications. U.S. industry has been vocal in raising concerns about the impact of these EU

regulations on U.S.-owned trademarks.

For these reasons, in 1999 the United States initiated formal WTO consultations with the EU on Regulation 2081/92. Bilateral discussions continued in 2000 and 2001 and intensified in 2002, following the European Commission's release of a number of proposed amendments to the regulation. While some of the proposed amendments to 2081/92 are intended to address the WTO concerns expressed by the United States, the proposed amendments do not address all of these concerns and, in some instances, raise new concerns. The consultations have thus far proved unsuccessful in resolving these issues.

Member State Practices

Some EU Member States have their own special practices regarding intellectual property protection and enforcement that do not necessarily comply with international obligations.

Belgium: Belgium collects levies on blank tapes and recording equipment to compensate rightsholders for the private, home copying of their works and to provide a source of funding for local productions. These levies are distributed by a national collecting society to the various categories of rightsholders according to statutory provisions. National treatment is denied to some U.S. rightsholders, however, and the United States motion picture and recording industries have not been able to collect their rightful share of these proceeds. Furthermore, pre-video release piracy in Belgium has caused an estimated loss of $12 million to the U.S. motion picture industry in 2002. Efforts to combat this piracy are hampered by slow enforcement procedures.

France: Video piracy and unauthorized parallel imports continue to impose significant losses on U.S. industry. Cable piracy and Internet piracy present further problems in this area. The deterrent effect of law enforcement is limited by the relatively mild penalties imposed on offenders by French courts.

Germany: Non-retail outlets (Internet, print media mail order, open-air markets) represent Germany's major piracy problem. Pirate videos, VCDs, and DVDs are sold primarily by residential mail-order dealers who offer the products via the Internet, newspaper advertisements, or directly sell them in flea markets. U.S. industry estimates that it lost over $50 million due to audiovisual piracy in Germany in 2001.

German IPR enforcement measures are quite strong. German copyright legislation currently allows the making of private copies, which makes it difficult to prosecute pirates who download music or video from the Internet and then distribute "burned" CDs or DVDs. The German government has prepared amendments to the Copyright Act to address this and other shortcomings mandated by EU directives, but the extent to which a right to private copies will be retained is still unresolved and controversial. However, the Parliament failed to take final action on this legislation before the September 2002 end of the last legislative session, and is now scheduled to consider the amendments early in the current session.

Italy: In 2000, Italy passed a long-awaited anti-piracy law, which had been introduced in Parliament in 1996. The U.S. Trade Representative moved Italy from the Special 301 "Priority Watch List" to the "Watch List" as a result. The law provides for significant administrative penalties and increased criminal sanctions for violations of music, film and software copyrights as well as the creation of an anti-piracy steering committee in the Prime Minister's Office to develop national anti-piracy strategies. Although the law and subsequent efforts by authorities and courts to implement it have reduced the incidence of piracy, a significant problem remains, especially in the emerging DVD and Internet markets. More traditional problems with unauthorized performances and broadcasts of motion pictures continue to surface episodically. The U.S. software industry is particularly concerned about a provision of the anti-piracy law that requires software to bear a label issued by the Italian royalty collection society, SIAE. The software industry maintains that this will cause unnecessary difficulties and additional costs without necessarily providing additional protection against piracy.

Spain: In a long-standing case, a well-known U.S. apparel manufacturer has pursued legal action against infringement of its brand name. While the Spanish Supreme Court ruled against the U.S. company's claims in September 1999, the company appealed to the Spanish Constitutional Court. The Constitutional Court accepted the case for review. A decision is

pending. Spain has generally enjoyed a low incidence of motion picture, i.e., video and audiocassette piracy. However in summer 2002 there was a sudden surge in street sales of pirate DVDs and videogames. Compact Disk (CD) piracy increased dramatically in Spain in 2002. An estimated 30 percent of CDs sold in Spain are pirated; estimated pirate sales for new releases of the most popular artists is 50 percent. Enforcement authorities have taken the threat seriously. In July 2002, Spain's Guardia Civil launched a special plan specifically to fight CD piracy. In July and August 2002 alone, the Guardia Civil shut down 16 pirate CD manufacturers, seized over 200,000 pirated CDs and arrested over 400 people.

Sweden: U.S. copyright industries voice concern over a provision in Swedish copyright law that denies to authors and producers of U.S. audiovisual works, and to the performers that appear in those works, the right to be compensated for private reproductions. U.S. industry questions the consistency of this practice with Sweden's national treatment obligations under the Berne Convention and its MFN obligations under the TRIPS Agreement. The government of Sweden has promised to rectify the problem in connection with the implementation of the EU Copyright Directive. The government was aiming to resolve the problem with legislation to be presented to Parliament in September or October 2002. However, the bill has been delayed, due to September general elections, and a delay in forming the new government. According to the Swedish Justice Ministry, the bill will be presented to Parliament in 2003.

SERVICES BARRIERS

Television Broadcast Directive

In 1989, the EU issued the Broadcast Directive, which includes a provision requiring that a majority of television transmission time be reserved for European origin programs "where practicable" and "by appropriate means." By the end of 1993, all EU Member States had enacted legislation implementing the Directive. The Commission is currently considering the parameters of a scheduled revision of the Directive.

Several countries have specific legislation that hinders the free flow of some programming. A summary of some of the more salient restrictive national practices follows:

France: The language of the EU Broadcast Directive was introduced into French legislation in 1992. France, however, chose to specify a percentage of European programming (60 percent) and French programming (40 percent) which exceeded the requirements of the Broadcast Directive. Moreover, the 60 percent European/40 percent French quotas apply to both the 24-hour day and to prime time slots. (The definition of "prime time" differs from network to network according to a yearly assessment by France's broadcasting authority, the "Conseil Supérieur de l'Audiovisuel," or CSA.) The prime time rules are a significant barrier to access of U.S. programs to the French market. France's broadcasting quotas were approved by the European Commission and became effective in July 1992.

In addition, the United States continues to be concerned about the French radio broadcast quota (40 percent of songs on almost all French private and public radio stations must be Francophone), which took effect on January 1, 1996. The measure limits the broadcast share of American music.

Germany: The German Youth Protection Authority, separate from the ratings and classification procedure currently in place, has the power at any time to designate or "index" films that it believes to be unsuitable for minors. U.S. industry has expressed particular concern that a film may be indexed at any time, thereby exposing distributors and retailers to the constant risk that their business may be subject to onerous restrictions for the sale and rental of indexed products. These provisions are dampening the fledgling DVD market, given that the costs to withdraw a particular title from release and/or to reedit it to make it meet the standards of the Youth Protection Authority are prohibitive. The indexing system could result in rightsholders manufacturing separate DVDs for Germany, whereas most DVDs are manufactured on a regional basis.

Italy: In 1998, the Italian Parliament passed Italian government-sponsored legislation including a provision to make Italy's national TV broadcast quota stricter than the EU Broadcast Directive. The Italian law exceeds the EU Directive by making 51 percent

European content mandatory during prime time, and by excluding talk shows from the programming that may be counted toward fulfilling the quota. Also in 1998, the Italian government issued a regulation requiring all multiplex movie theaters of more than 1,300 seats to reserve 15 percent to 20 percent of their seats, distributed over no fewer than three screens, to showing EU films on a "stable" basis. In 1999, the government introduced antitrust legislation to limit concentration in ownership of movie theaters and in film distribution, including more lenient treatment for distributors that provide a majority of "made in EU" films to theaters.

Spain: Despite remaining protectionist elements, Spain's theatrical film system has been modified sufficiently in recent years so that it is no longer a major source of trade friction. New government regulations issued in 1997 eased the impact of a 1994 cinema law. The screen quotas adopted in 1997 require exhibitors to show one day of EU-produced film for every three days of non-EU-produced film instead of the original ratio of one to two. In July 2001, after lengthy debate about eliminating film screen quotas, the Spanish Parliament adopted new legislation that maintains quotas. The new law calls for revisiting the issue of potential quota elimination in 2006.

Postal Services

U.S. express and package service providers remain concerned that postal monopolies in many EU Member States restrict their market access and subject them to unequal conditions of competition. In October 2001, EU Member States agreed to open additional postal services to competition beginning in 2003, including all outgoing cross-border mail. Depending upon the results of a European Commission study (scheduled to be completed by the end of 2006), full liberalization of the EU postal market could occur by 2009.

The procurement of postal services will soon be regulated by the proposed new Utilities Directive, as the procedures for the award of contracts which are applied by entities operating in the postal services sector will fall under the scope of the proposed Directive. The European Parliament and Council are debating this proposal, which is not expected to be approved before 2005 at the earliest.

Belgium: American firms continue to focus attention on cross-subsidization occurring under the umbrella of the Belgian railroad monopoly. Their concern is that the Belgian state railroad is using its monopoly in rail passenger transportation to cross-subsidize the mail transport business it operates outside any existing Belgian legal entity. The Belgian railroads are also exempt from VAT on their mail transport business and reportedly never pay any of the fines frequently incurred by private mail operators. Such cross-subsidization apparently results in abuse of the railroad's dominant market position when competing with foreign private express mail services. The Belgian Postal Group is also developing express mail units to compete with private sector operations in this field. This would give rise to additional concerns regarding cross-subsidization. Concerns have also been expressed about a possible joint venture between the Belgian Postal Group and Belgacom on secure Internet communications. The dominant positions held by the two publicly owned incumbents could limit competition from other Internet Service Providers (ISP) in the electronic communications markets.

Germany: The German government, in July 2001, decided to extend Deutsche Post's letter monopoly until 2007, thus extending its exclusive service for letters under 50 grams by an additional five years beyond the period foreseen in the German Postal Law of 1997. In June 2002, the European Commission found, in a case originally brought by a U.S. firm in 1994, that Deutsche Post had illegally used state aids to cross-subsidize its package delivery services. The Commission ordered Deutsche Post to repay Euro 906 million to the German government. After some delays by the German government (which still owns approximately 78 percent of Deutsche Post) in ordering Deutsche Post to pay the fine, Deutsche Post paid the fine in January 2003. Deutsche Post has appealed the Commission's decision to the courts.

Professional Services

In the area of professional services, there are significant variations in EU Member State requirements for foreign lawyers and accountants intending to practice in the European Union. While many of these are not overt barriers, disparities among EU Member

State requirements can complicate access to the European market for U.S. lawyers and accountants.

Legal Services

Austria: To provide legal advice on foreign and international law on other than a temporary basis, the establishment of a commercial presence is required as well as joining the Austrian Bar Association. Only an Austrian or other EU national can join the Bar Association. Equal treatment under the EU's "Directive to Facilitate the Practice of the Profession of Lawyer on a Permanent Basis in a Member State" is granted to lawyers from the EU or the European Economic Area (EEA). For third country citizens, GATS provisions apply, which means that U.S. citizens cannot practice law in Austria.

Denmark: Foreign legal consultants are restricted in their ability to advertise, including restrictions on the use of letterhead or signs on office doors. These restrictions are not applied to attorneys licensed to practice Danish law. There are restrictions on the ability of foreign lawyers to associate with Danish lawyers. Foreign attorneys may hire Danish attorneys in private firms but foreign attorneys who are not members of the Danish bar cannot own a Danish firm. Also foreign attorneys who do not also have appointment as Danish attorneys cannot be partners in a Danish legal firm. To be an attorney in Denmark, a person must be a Danish law school graduate and clerk in a law firm for three years.

Finland: Foreigners from non-EU countries cannot become members of the Finnish Bar Association and receive the higher law profession title of "Asianajaja." This does not, however, prevent persons from practicing domestic or international law (including EU law) using the lower level title of "Lakimies" or "Jurisiti." A Finn must pass a test and have five years of legal experience before becoming an "Asianajaja." The title gives added prestige and helps solicit clients, but is not essential to practice law.

France: There is a nationality requirement to qualify as a practicing lawyer "avocat." Non-EU firms are not permitted to establish branch offices in France under their own names. Also, non-EU lawyers and firms are not permitted to form partnerships with or hire French lawyers.

Germany: Foreign lawyers cannot automatically practice German law in Germany. Foreign lawyers from WTO Members who have joined the German Bar Association under their home title, may practice international law (but not EU law) and the law of their home country. Lawyers from non-WTO Members may only practice the law of their home country. To be admitted to the bar to practice German law, individuals on average complete five years of study before taking the German bar examination.

Ireland: Lawyers with non-Irish qualifications who wish to practice Irish law and appear before Irish courts must either pass "transfer" examinations or retrain as lawyers under the direction of the Law Society of Ireland. Only lawyers who have either been admitted to the Bar of England, Wales, or Northern Ireland, practiced as an attorney in New York, Pennsylvania (with five years experience required in Pennsylvania), or New Zealand, or have been admitted as lawyers in either an EU or EFTA Member State are entitled to take the "transfer" examination.

Italy: In 2001, Italy passed a law implementing EU Directive 98/5 on the pan-EU freedom of establishment of EU lawyers, and enabling Italian lawyers to practice jointly, including with EU lawyers, through an Italian "società tra avvocati" ("company of lawyers" a type of limited liability partnership) or through the Italian branch of a partnership formed in another EU member State, so long as the "società tra avvocati" or partnership is composed exclusively of Italian and EU lawyers. Although the status of non-EU lawyers is not expressly addressed by the law, Italian lawyers may not practice jointly with them in a "societa tra avvocati" or similar foreign partnership. This leaves the status of the (EU and non-EU) international law firms with offices in Italy uncertain, insofar as they have Italian and non-EU lawyers as partners.

Accounting and Auditing Services

Austria: Persons authorized to offer professional accounting services in Austria are required to have a registered office in Austria or another EU or EEA Member State. Under Austria's GATS obligations, foreign accountants may form a partnership with a local firm. Alternatively, they may qualify

locally by passing professional exams and meeting other standards.

France: There is a nationality requirement for establishment of a practice, which can be waived at the discretion of the French authorities. However, an applicant for such a permit must have lived in France for at least five years.

Greece: The transition period for de-monopolization of the Greek audit industry officially ended on July 1, 1997. Numerous attempts to reserve a portion of the market for the former state audit monopoly during the transition period (1994-97) were blocked by the European Commission and peer review in the OECD. In November 1997, the government issued a presidential decree that effectively undermines the competitiveness of multinational auditing firms. The decree established minimum fees for audits, and restrictions on the use of different types of personnel in audits. It also prohibited auditing firms from doing multiple tasks for a client, thus raising the cost of audit work. The Greek government has defended these regulations as necessary to ensure the quality and objectivity of audits. However, in practice the decree represents a step back from deregulation of the industry.

Telecommunications Market Access

Both the WTO Basic Telecommunications Agreement and newly proposed EU legislation have spurred deregulation in the European telecommunications sector. Under the WTO Agreement, for example, all EU Member States made commitments to provide market access and national treatment for voice telephony and data services. However, liberalization and harmonization have been uneven across the EU's Member States, as reflected below. In most markets significant problems remain with the provisioning and pricing of unbundled local loops, line sharing, co-location and the provisioning of leased lines. The presence of government ownership in some EU Member States' incumbent telecommunications operators also has the potential to raise problems for new entrants.

In December 2001, the European Parliament and Council of Ministers agreed on five new Directives to regulate electronic communications networks and associated services. Moreover, in December 2000, the EU passed a Regulation mandating "local loop unbundling," and in July 2002 a directive extending the EU's data protection regime was extended to all electronic communication. A separate directive updating the EU's Data Protection regime remains under discussion in the European Council and Parliament. These seven pieces of legislation are meant to replace the twenty-plus Directives that currently cover the sector, update and adapt European legislation to developments such as the continuing convergence of technologies, and establish a system that will be responsive to future technological and market developments. The new regulatory framework will apply to all forms of electronic communications networks and associated services, not just traditional fixed telephony networks. The longterm goal is to phase out sector-specific, *ex-ante* regulation (for all but public interest reasons) in favor of reliance on general competition rules. The full package will not come into effect until mid-2003, at the earliest, but the Unbundling Regulation, which requires incumbent operators to offer the full range of unbundled access to the local loop to competitors, was approved on an accelerated timetable and took effect on January 1, 2001.

Member State Practices

Enforcement of existing legislation by National Regulatory Authorities (NRA) appears hampered by unnecessarily lengthy and cumbersome procedures in France, Italy, Austria, and Portugal, and by low penalties in Ireland and Germany. The European Commission also found that incumbents in Germany, Greece, Spain, Italy, Ireland, Austria, Finland, and Sweden have slowed the arrival of competition by systematically appealing their national regulators' decisions despite the fact that in most cases the appeals are not successful.

Austria: On January 28, 2001, the NRA published guidelines for sharing telecommunications infrastructure sites, but not networks or frequencies, by operators licensed to offer third generation wireless services (known as UMTS in Europe).

Belgium: Competitive operators continue to raise concerns about the slow pace at which Belgacom, the dominant telecommunications supplier, is unbundling the local loop. Despite agreements reached between Belgacom and

other operators on opening the "last mile," the number of unbundled lines remains low. Belgacom remains the *de facto* monopolist for advanced Digital Subscriber Lines (ADSL) despite the introduction of policies to help liberalize the market for high-speed Internet access. Competing Internet Service Providers (ISP) have also criticized Belgacom for not offering flat-rate Internet access. As such, Belgacom invoices nearly all dial-up users even when users have chosen a competing ISP. With respect to mobile telephony, Belgacom Mobile, along with Mobistar, were designated by the Belgian regulation as having significant market power for the year 2002. There continues to be concern over the lack of independence of the Belgian regulator, the Belgian Institute for Postal Services and Telecommunications (BIPT). BIPT is supervised by the Minister of Telecommunications, who is also responsible for the Belgian government's 51 percent shareholding in Belgacom. The Belgian government has announced its intention to further privatize Belgacom, but little progress has been made.

Finland: In Finland, traditional operators still hold 80 percent to 90 percent of local loop operations. Amendments to the Telecommunications Market Act passed in March 2001 intend to increase competition in local networks by creating a new right-of-use obligation in network operations under which local operators are obliged to offer for rent their upper band subscriber lines to other telecommunications service providers (local loop unbundling). Customers are allowed to obtain competitive bids from different telecommunications service providers. As of September 1, 2001, Finns have been able to make local calls using the operator of their choice and choose which operator is used when calling from a fixed-line phone to a mobile subscriber.

In the second stage of comprehensive communications reform, a completely new legislative framework, a new Communications Market Act, was created. A government bill was submitted to Parliament in September 2002. It supports network business, television and radio operations and content production. The aim is to improve the legislative environment for competing businesses, development of communications technology and innovations. Furthermore, the bill implements four new Directives on electronic communications. Internet Service Providers are also included in the scope of the Act. In February 2003, Parliament adopted the new Communications Market Act and other legislative amendments related to the same government proposal. The Acts will enter into force in July 2003.

In early 2002, Sonera and Swedish Telia announced their plans to merge. On December 9, 2002, Telia announced the completion of its exchange offer for all of the outstanding shares of Sonera and changed its name to TeliaSonera. The government of Finland owns 19.4 percent of the merged company. As of February 10, 2003, following the completion of the mandatory redemption offer, TeliaSonera's total holding of Sonera represents 99.4 percent.

France: The regulatory agency Autorité de Régulation des Télécommunications (ART) continues to make progress in prodding France Telecom (FT), still 54 percent government-owned, to comply with EU Directives and French law. Following complaints by United States and other competitors about leased-line pricing and provisioning, the ART forced FT to lower its interconnection proposal for 2002. Fully unbundled access tariffs, shared access tariffs, and connection costs were further reduced in mid-2002. Addressing another long-standing complaint by competitors, the ART promised to make fixed-to-mobile termination rates more cost-oriented, lowering them 40 percent over three years. Following through on these promised rate reductions, in November 2002 the ART announced that Orange and SFR (the two mobile operators with significant market power in interconnection) will decrease their call termination charges by 15 percent on average by January 2003.

The record remains mixed on liberalizing the high-speed Internet market. Unbundling became effective in January 2001, and some companies that have contracted with FT to install their asymetrical digital subscriber line equipment on its lines have started offering high-speed services to business customers. That development along with several metropolitan optical loops for corporate clients, has resulted in strong competition in France's four largest cities. However, competition is still fragile in six other urban areas and nonexistent in the rest of the country. For non-corporate high-speed Internet services, France

Telecom maintains a dominant position, primarily thanks to its control of the local loop. In late 2002, the ART began tearing down restrictions that have hamstrung use of short-range Wi-Fi (wireless fidelity) technology for wireless local area networks (LANS), a promising alternative for high-speed Internet services.

Germany: Germany has made progress in introducing competition to some sectors of its telecommunications market. However, new entrants continue to face difficulties competing with the incumbent Deutsche Telekom AG (DT), which retains a near-monopoly in a number of key services, including local loop and DSL connections. The Regulatory Authority for Telecommunications and Posts (RegTP) issued a number of pro-competitive rulings during 2002, but the incumbent challenged virtually all of them, which led to extensive delays in implementing these otherwise positive decisions. RegTP ordered that DT face deadlines in provisioning of leased lines, and be required to provide wholesale flat-rate Internet products. However, both these decisions were delayed after the first round of court challenges by DT. In September 2002, the German parliament passed a limited revision of the telecommunications act to allow for carrier preselection for local calls. Implementation of preselection, however, has been delayed from December 2002, as originally foreseen in the law, until mid-2003. Many other RegTP cases remained tied up in a cycle of court challenges, appeals and counter-appeals. Competitors maintained, and some RegTP officials agreed, that the cumbersome German legal system had become something of a barrier to competition. Competitors hope the planned revision of the German telecommunications law, scheduled for mid-2003, can provide a stronger basis for pro-competitive regulation.

Throughout 2002, competitors charged that DT continued to engage in a variety of anticompetitive practices. In January 2003, several telecommunications trade associations and private firms filed complaints with the U.S. Government under Section 1377 of the Omnibus Trade and Competitiveness Act of 1988. The submissions asserted, *inter alia*, that: timely interconnection and timely unbundling of the local loop remained serious problems; DT's unbundled rates were not cost-oriented; DT's broadband monopoly remains unchallenged, and DT and other mobile providers charge excessive termination charges when fixed-line users call mobile phones.

Ireland: The government privatized the state monopoly, Telecom Eireann, in 1999, but the new company, Eircom, retains either market dominance or significant market power in fixed lines (79 percent share) and leased line services and national interconnection. Thus, while there are currently 42 fixed line licensed operators in the Irish market, 19 of which are active, these new entrants only account for 21 percent of the fixed line market. Competition has significantly reduced prices for international business and residential calls, while the price for local service remains high, discouraging both broadband development and Internet use.

Significant competition is now emerging in the mobile phone market, with three licensed and active operators. The mobile penetration rate in Ireland in 2002 was 76 percent; there are 2.97 million mobile subscribers. Following adoption of EU local loop unbundling legislation, the Irish government committed to full liberalization of access to the "last mile" of telephone lines on January 1, 2001. However, progress has been slow. The industry regulator, the Office of the Director of Telecommunications Regulation (ODTR), was embroiled in a legal dispute with Eircom over the tariffrate for the "last mile." This dispute was settled in April 2002, which resulted in an overall reduction on charges offered by Eircom. The determination of interconnection rates will benefit new entrants and Irish rates now compare more favorably with prices across the EU.

Italy: The Italian telecommunications market has made substantial progress toward full liberalization. Fixed telephony is fully open to competition, with more than 250 operators licensed to provide commercial services to include Internet access, local calls, long distance, and international service. Four GSM operators are fully operational. Five third generation cellular (UMTS) licenses were awarded in October 1999, after a very brief and controversial bid procedure resulting in an early closure of the tender that left the Italian government with substantially lower revenues from the sale than had been anticipated. As elsewhere, the start of UMTS in Italy has been delayed by the market slowdown, high-licensing costs, and bureaucracy involved in

launching such services. The local loop is now open to competition. One issue of concern is the continued and increasing State role in the telecommunications sector. The Italian government still holds about 3 percent of former monopolist Telecom Italia and is still able to influence company strategies. The Italian government holds a majority interest in ENEL (the national electricity conglomerate that in turn owns a controlling interest in cellular operator WIND and fixed line operator INFOSTRADA). In addition, the Italian government owns interests in other participants in telecommunications consortia operating at the national level.

Spain: The Spanish regulator introduced in 2001 a wholesale offer for the provision of leased lines and a significant price reduction in 2002, but wholesale prices are still above the European average and around 100 percent above prices charged in the U.S. Leased lines are the main mechanism of access to large clients and their price determines the final price of all the downstream services (voice, data etc.). Because leased line prices are not cost-oriented, the incumbent operator Telefónica can offer to final customers discounts on the leased line which eliminate any advantage in the prices of the downstream services which could be offered by alternative operators. Spanish mobile operators are charging excessive prices for their mobile termination services. The Spanish regulator imposed a reduction of 17 percent on these prices in July 2002, but there is still a wide margin between costs and prices. U.S. citizens and companies calling to European mobile numbers are charged an excessive price. American operators active in the European markets are squeezed out from the fixed-to-mobile communications markets, as mobile operators offer retail mobile-to-mobile and fixed-to-mobile calls at prices below the wholesale termination price.

Implementation of the 2001 unbundling of the local loop has been slow and problematic, and many operators have withdrawn from the market. Although Telefónica's market share is slowly being reduced, it is still the dominant player and it is difficult for new entrants to operate on a commercially viable basis in Spain. Competitors that have tried to negotiate nondiscriminatory access directly with Telefónica have been met by refusal from the incumbent, and at times disinterest by the regulator. Telefónica operates the network and is the number one digital subscriber line (DSL) service provider, i.e., competitor to its loop customers, and therefore is in the position to favor its own downstream services and discriminate against competitors. The company has done so through lack of information, discriminatory collocation conditions, slow implementation and slow negotiations. Telefónica also intends to restrict the type of equipment that can be collocated, and the government of Spain has sanctioned a phased-in approach to opening Central Offices to collocation for DSL service. This will allow Telefónica to introduce DSL services in profitable markets without competition. Telefónica also has not provided information on the condition or availability of local loop interconnection on its incomplete list of Central Offices provided to competitors. In addition, Telefónica also has no binding deadline for the availability of an Operational Support System to new entrants, necessary for order entry, provisioning, repair, maintenance and billing functions. Also, the loop management plan is restrictive in that it is based on management rules that are managed by Telefónica, as opposed to standards-based rules.

Sweden: The EU directive on Local Loop Unbundling was implemented in Sweden on January 2, 2001. The Swedish Post and Telecommunications Agency (PTS) has received complaints from a number of operators claiming that the incumbent (Telia) is acting in a discriminatory manner. Complaints include accusations of lack of delivery as well as conditional delivery of access. PTS is currently investigating whether Telia is *de facto* acting in violation of the directive.

Another source for complaint is Telia ownership of Skanova, which operates the infrastructure that Telia owned before it was semi-privatizatized. Other operators would prefer that Telia sell Skanova in order to create healthier competition in the Swedish market.

United Kingdom: There is little competition in advanced data services over fixed-line incumbent British Telecom's (BT) infrastructure. In a recent OECD study, the UK ranked near the bottom of OECD countries in the use of broadband services. BT has been criticized by potential competitors for blocking access to its network so that alternative broadband services could be offered; at the same time, BT has been slow to offer its own

high-speed data services. Competition in high-speed services is emerging, however, with cable television companies offering lower-priced broadband access over their own infrastructure. In 2002, the integration of broadband services increased rapidly in the UK: one million people had purchased the service by October and 30,000 people a week were subscribing in late 2002. The government has stated that it aims to become the leader in broadband services among G-7 countries by 2005, and the government, including the Prime Minister, have recently given the goal high-level attention.

INVESTMENT BARRIERS

The EU's competency in investment issues is evolving and it has a growing role in defining the way in which U.S. investments in EU Member States are treated. Still, in many instances Member State practices are of more direct relevance to U.S. firms. Under the 1993 Maastricht Treaty, free movement of capital became an EU responsibility and capital controls both among EU Member States and between EU members and third countries were lifted. However, a few Member State barriers existing on December 31, 1993 remain in effect, although EU law can now supersede these. Right of establishment issues, particularly regarding third countries, is a shared competence between the EU and the Member States. The division of this shared competence varies from sector to sector, based on whether the EU has legislated regulations in that sector. Direct branches of non-EU financial service institutions remain subject to individual member country authorization and regulation. EU Member States negotiate their own bilateral investment protection and taxation treaties, and generally retain responsibility for their investment regimes, until and unless they are superseded by EU law. The EU supports national treatment for foreign investors in most sectors. Once established, EU law, with a few exceptions, requires that any company established under the laws of one Member State must, as a "Community undertaking," receive national treatment in all Member States, regardless of its ultimate ownership. However, some restrictions on U.S. investment do exist under EU law and others have been proposed (see below).

During 2002, the European Commission conveyed to the United States its concern that certain provisions of Bilateral Investment Treaties (BITs) between the United States and Central and Eastern European countries could conflict with EU law following the entry of these countries into an enlarged EU. The United States and EU have engaged in consultations on this issue. The United States has stressed the importance of preserving the treaties and the protections they afford to U.S. investors, but has expressed a willingness to explore ways to meet EU concerns regarding legal consistency.

Ownership Restrictions and Reciprocity Provisions

The right to provide maritime transport services within certain EU Member States is restricted. EU banking, insurance and investment services Directives include "reciprocal" national treatment clauses, under which financial services firms from a third country may be denied the right to establish a new business in the EU if the EU determines that the investor's home country denies national treatment to EU service providers. The right of U.S. firms to national treatment in this area was reinforced by the EU's GATS commitments. In the EU Hydrocarbons Directive, the notion of reciprocity may have been taken further to require "mirror-image" reciprocal treatment, under which an investor may be denied a license if its home country does not permit EU investors to engage in activities under circumstances "comparable" to those in the EU. It should be noted, however, that so far no U.S.-owned firms have been affected by these reciprocity provisions.

Member State Practices

Austria: While European Economic Area Member States' banks may operate branches on the basis of their home country license, banks from outside the EEA must obtain an Austrian license to operate in Austria. However, if such a non-EEA bank has already obtained a license in another EEA country for the operation of a subsidiary, it does not need a license to establish branch offices in Austria.

France: There are no general screening or prior approval requirements for non-EU foreign investment. Notification requirements apply to foreign investments, EU and non-EU, for acquisition of a stake of more than 5 percent in the capital of a firm in the national defense,

public safety, or public health sector. The government is able to exert influence over privatized firms through "golden share" provisions. The use of "golden shares" remains exceptional. The French government transformed its golden share in the aerospace firm Aerospatiale-Matra into an ordinary share in July 2000, and in October 2002 eliminated its golden share in the oil company Elf-Aquitaine (which subsequently entered into Total-Fina-Elf) following the June 2002 decision of the European Court of Justice affirming the principle of free movement of capital in the EU. France continues to apply reciprocity requirements to non-EU investments in a number of sectors. For the purpose of applying these requirements, the French government generally determines a firm's residency based on the residency of its ultimate owners rather than on the basis of the firm's place of establishment or incorporation.

Germany: Germany's new takeover law, which came into effect on January 1, 2002, has reintroduced measures that allow firms to ward off hostile takeover bids: first, at the stockholder level, where management may be given authority at the annual shareholders meeting to take measures deemed necessary to guard against unwanted interest; and second, at the management level, where the managing board can take protective measures upon approval by the supervisory board – bypassing the need for stockholder approval altogether. These provisions may have negative consequences for outside investors and stockholders.

Greece: Greek authorities take into serious consideration local content and export performance when evaluating applications for tax and investment incentives. However, these factors are not mandatory prerequisites for approving investments.

Greece, which restricted foreign and domestic private investment in public utilities (except for cellular telephony and energy from renewable sources, e.g., wind and solar), has recently opened its telecommunications market and has plans to gradually liberalize its energy sector. As of January 1, 2001, the traditional voice telephony market and the market for providing infrastructure for it has been opened to EU firms. The Greek energy market entered a phase of deregulation in February 2001. The electricity market in Greece will have to be fully deregulated by 2005. At present, Greece's inhospitable regulatory framework has hampered attempts by U.S. firms to develop much needed energy production facilities. For example, the Development Ministry has continually refused to grant licenses to several U.S. renewable energy providers to connect to the Greek transmission grid.

Extensive red tape and contract delays also are major impediments to U.S. investments in Greece. There are national security-related restrictions for non-EU investors on land purchases in border regions and on certain islands.

Portugal: Most foreign investments in Portugal are only subject to *post facto* registration. However, Portugal retains the discretion to limit foreign investment, on a case-by-case basis, in state-owned companies that are being privatized. To date, this prerogative has not been exercised.

United Kingdom: On December 1, 2001, the Financial Services Authority (FSA) assumed its full powers and responsibilities under the Financial Services and Markets Act of 2000. In its role as the single statutory regulator responsible for deposit-taking, insurance and investment business, the Authority requires that key staff at regulated firms be approved by the Authority. Although the rules apply to all banks, globally managed banks had noted the rules would pose a large administrative burden on them, and require that hundreds of bankers already working in the UK seek FSA approval. However, firms and individuals that held equivalent status under the old legislation are being grand-fathered, which means that firms can carry on without re-applying for permission or approval.

ELECTRONIC COMMERCE

The European Union currently maintains no significant barriers to electronic commerce. However, U.S. businesses and the U.S. Government continue to monitor potential problems related to data privacy regulation and taxation of electronic transactions.

Data Privacy

Data privacy retains a high profile in transatlantic relations. There are three relevant EU Directives: a horizontal Directive on Data

Protection that was adopted in 1995 and took effect in October 1998; a telecommunications-specific Data Privacy Directive that was adopted in 1997 and took effect in October 2000; and a Directive on Privacy and Electronic Communications that extends coverage to all electronic communications passed in July 2002 and is slated to be transposed into Member State laws by October 2003. Several Member States have yet to implement the two Directives already in force, and the Commission is pursuing infringement proceedings against five Member States that have not yet completely implemented the first Directive.

The horizontal Directive seeks to protect individual privacy with regard to the storage, processing and transmission of personal data, while still permitting the free flow of data within the EU. It allows transmission of data to third countries, if those countries are deemed by the EU to provide an adequate level of protection, if the recipient can provide other forms of guarantee (e.g., a contract) that ensures adequate protection, or if the data transfer falls within the limited exceptions in the Directive. The United States and the European Commission concluded in July 2000 a "Safe Harbor" arrangement that bridges the differences between the EU and U.S. approaches to privacy protection and will help ensure that data flows are not interrupted. Under the Safe Harbor arrangement, U.S. companies can voluntarily participate in the Safe Harbor by self-certifying to the Department of Commerce. Currently, only entities whose activities fall under the regulatory authority of the Federal Trade Commission or the Department of Transportation are eligible to participate in the Safe Harbor. Whether or how other sectors, in particular financial services (banks, insurance, credit unions), telecommunications common carriers and not-for-profits, will be considered in relation to Safe Harbor will be determined in the future.

The U.S. Department of Treasury and the EU Commission agreed at the time the safe harbor arrangement was concluded that separate talks should continue on bringing the benefits of an adequacy finding to the financial services industry. Both sides agreed that it was essential to take into account the additional privacy protections applicable to U.S. financial institutions that would be implemented in 2001 under the Gramm-Leach-Bliley Act of 1999. Discussions on this issue are ongoing.

The telecommunications Data Protection Directive addresses issues such as the storage of customer data and gives consumers rights related to unsolicited calls or faxes as well as inclusion in directories. The new draft privacy Directive proposed in July 2000 includes an update that would expand coverage to all kinds of electronic communications networks and associated services (e.g., Internet services would be covered). It also introduces more stringent restrictions on unsolicited commercial mail and directory services. The proposal has raised a number of questions and practical concerns regarding transnational implications of its implementation on both sides of the Atlantic and its ultimate impact on U.S. service providers remains to be seen.

Taxation of Electronic Commerce

On May 7, 2002, the Council adopted Directive 2002/38/EC setting out the principles of the system to collect Value Added Tax on electronic commerce transaction. While EU Member States have agreed that no new or additional taxes should be imposed on electronic commerce, they found that existing taxes should be adapted and applied. In each EU Member State, a domestic value-added tax (VAT), which is a consumption tax, is payable on deliveries of goods and the provision of services. In this regard, the Council agreed that electronic commerce transactions that do not involve the delivery of physical goods are a provision of a service subject to VAT, no matter whether the services are supplied from inside or outside the EU. The proposed Directive would require that non-EU suppliers register with a VAT authority in a single Member State. The VAT on digital products supplied from outside the EU would be levied at the rate applicable in the customer's country of residence, and VAT revenue then reallocated from the supplier's country of registration to that of the customer.

U.S.-based businesses have expressed concern over the potentially discriminatory effects of this proposed Directive. Specifically, U.S. businesses are concerned that the proposed Directive treats U.S. suppliers of digital products less favorably than their EU counterparts. For instance, under the Directive, U.S. suppliers would be obliged to collect and remit VAT at 15 different rates (depending on the consumer's Member State of residence).

By contrast, EU suppliers would only be obliged to collect and remit VAT at the rate of the single Member State in which that supplier is registered. Moreover, the Directive appears to create more stringent administrative burdens for U.S. suppliers, including strict verification and data storage requirements. If the Directive is formally adopted by Member States, it would likely be implemented by 2003. The system would be applied for an initial period of three years and could then be extended by the Council at the request of the European Commission.

Member State Practices

Austria: Although Austria was among the first EU countries to introduce a comprehensive law on electronic signatures in 1999, private businesses complain that only government and quasi-government agencies will be allowed to conduct accreditation to firms to ensure they are certification providers for "qualified" signature certificates.

OTHER BARRIERS

Subsidies for Fruit and Canned Fruit

EU shipments of heavily subsidized canned peaches continue to distort world markets to the detriment of U.S. producers. Similarly, EU subsidies for the production of table grapes, cherries and clementines affect U.S. exports to the EU and globally. Although a 1985 U.S.-EU Canned Fruit Agreement brought some discipline to processing subsidies, significant fraud and abuse have undermined the discipline imposed by the Agreement. Under the EU's current subsidy regime, a per-ton payment is made directly to producer organizations such as cooperatives. The United States will continue to monitor EU subsidies to this sector and evaluate their trade-distorting effects.

Subsidies for Propellents

France: A U.S. manufacturer of propellants alleges that a French government-owned firm is seeking to expand its share of the U.S. propellant market through unfair trade practices. Specifically, the French government is alleged to be providing subsidies to the French firm which may not conform with WTO obligations, and permitting the sale of propellant at prices below the cost of production. The United States is reviewing this matter in light of French and EU WTO obligations.