EUROPEAN UNION

TRADE SUMMARY

The European Union (EU) and the United States share the largest two-way trade and investment relationship in the world. In 2001, the U.S. trade deficit with the EU was $ 60.9 billion, an increase of $ 5.9 billion from the U.S. trade deficit of $55.0 billion in 2000. U.S. goods exports to the 15 Member States of the EU were nearly $159.2 billion, a decrease of 3.6 percent from the level of U.S. exports to the EU in 2000. U.S. imports from the EU were $220.0 billion, an increase of 0.01 percent from the level of imports in 2000.

U.S. exports of private commercial services (i.e., excluding military and government) to the European Union were $90.0 billion in 2000 (latest data available), and U.S. imports were $74.7 billion. Sales of services in European Union by majority U.S.-owned affiliates were $180.5 billion in 1999 (latest data available), while sales of services in the United States by majority European Union-owned firms were $155.3 billion.

The stock of U.S. Foreign Direct Investment (FDI) in the EU in 2000 amounted to $573.4 billion, 46 percent of U.S. FDI to the world. U.S. FDI in the EU was concentrated largely in the finance, manufacturing and services sectors.

IMPORT POLICIES

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 imported wines 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. The current derogation that has been extended to the U.S. expires on December 31, 2003. Absent a health or safety concern, U.S. law effectively grants automatic acceptance of EU wine making practices.

U.S.-EU negotiations on a bilateral wine agreement were launched in 1999 and continued throughout 2001. 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 expressed an interest in obtaining labeling protection for its wine names in the EU.

The EU has sought to impose similar labeling restrictions for "traditional expressions." Traditional expressions are, for the most part, terms used with certain other expressions (often geographical indications) to describe wine or liqueur. These terms are granted protection in the EU, although: (i) third country industry does not have a means to apply for or protest applications for such protection; and (ii) in many cases the terms are generic (e.g., "aged five years," "ruby" and "tawny" are protected "traditional terms" by the EU, meaning these words cannot be used for imported wines). The United States does not recognize the concept of traditional terms as a

form of intellectual property, nor is this subject covered under the TRIPS Agreement.

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

Spanish and Portuguese Corn Tariff-Rate Quotas

Historically, annual EU corn imports have totaled approximately three million metric tons with over 500,000 metric tons imported by the Northern European corn millers and the rest by Spain and Portugal under reduced duty quotas. However, imports of U.S. corn under this arrangement have stopped due to the breakdown in the EU's regulatory system for approving new varieties of commodities using modern biotechnological techniques (see "Biotechnology" below).

The Spanish and Portuguese tariff-rate quotas (TRQs) for corn and sorghum were created as a result of the 1987 U.S.-EU Enlargement Agreement, which provides compensation to the United States for trade losses from the accession of Spain and Portugal to the EU. The TRQs ensure minimum annual Spanish purchases of two million metric tons of corn and 300,000 metric tons of sorghum, minus Spanish imports of certain non-grain feed ingredients (NGFIs). The import requirement, while falling short of Spain's pre-EU accession level of corn and sorghum imports, provides some compensation for the replacement of Spain's 20 percent pre-accession bound tariff with the EU's pre-Uruguay Round variable levy system.

Additionally, as part of the Blair House oilseeds settlement, there is a separate 500,000 metric ton TRQ for corn imported into Portugal. These TRQs are both administered by the EU on an MFN basis, but historically have been supplied mostly by the United States.

In addition, since Spain incorporated the Canary Islands into its customs and statistical data in 1997, the EU has been counting corn imported by the Canary Islands against Spain's import obligation. However, the Canary Islands have a zero duty on corn and were not part of Spain's customs area when the EU's commitment was established. This has resulted in approximately 350,000 metric tons less corn imported under the TRQ since 1997.

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 State public health authorities impose their own strict price controls on pharmaceuticals. As a result, since 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) and undermine the ability of pharmaceutical companies to set prices for their products. This practice also undermines pharmaceutical companies' ability to recoup their research and development costs.

Another impediment stems from the EU policy of

testing each batch of pharmaceuticals imported from the United States for quality at the point-of-entry. The testing obligation is costly and time-consuming, and delays market access and increases market costs. It places U.S.-based pharmaceutical manufacturers at a competitive disadvantage.

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 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 infringes the timeliness and transparency guidelines of the EU Transparency Directive and has perpetuated a closed market system favoring established suppliers.

Based on company complaints, the European Commission filed a claim at the European Court of Justice (ECJ) against Austria. On November 27, 2001, the ECJ ruled that Austria is required to install an "independent judicial instance" to review the first decision made by a medical association in the approval process. In addition, all decisions must be issued in the form of an official ruling. The U.S. and Austrian Governments are also discussing HVB approvals in their Informal Commercial Exchange (ICE) talks, with a view to speedier and more transparent approvals.

Belgium: In Belgium, there are significant delays in providing market authorization and approval of pricing and reimbursement for new pharmaceutical products. The continuation of these delays, as well as pricing and tax issues, represents a step backward from the situation in 2001. The Belgian government in 2000 formally pledged to put into place legislation that would conform Belgian practice to relevant EU Directives. As of early 2002, this legislation was still not in place. According to industry sources, the current average timeframe for authorization and pricing approval is approximately 566 days, in contrast to EU requirements of a maximum of 390 days for the entire process. Industry officials estimate that the mean delay for price reimbursement is now 464 days, well in excess of the 180 days required by the EU. The lengthy process to obtain marketing approval in Belgium shortens considerably the period of patent protection. Under the centralized European procedure, mandatory for new products, the supplementary protection certificate period depends on the date of first approval. U.S. companies are disproportionately affected by procedural delays as they are among the most active 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 a mandatory price reduction for drugs on the market for fifteen years. A four-percent turnover tax is charged on all sales of pharmaceutical products. Price controls for reimbursed and non-reimbursed products affect not only domestic sales, but also export sales to third markets for which the Belgian price is the reference price. More generally, the U.S. pharmaceutical industry considers the Belgian situation regarding pharmaceuticals to be inconsistent with the concept and structure of the European internal market.

The European Commission decided in February 2002 to refer to the ECJ several aspects of the Belgian system for making medicinal products eligible for reimbursement by the health insurance scheme. The Commission considers these requirements to be barriers to the free movement of goods within the EU.

France: The December 1997 law governing the financing of France's social security system was designed in part to impose strict limits on health

expenditures, particularly in the area of pharmaceuticals, where the increase in expenditures was capped at two percent in 2000. The French government exacts rebates from companies for sales exceeding an established limit and imposes a levy on pharmaceutical companies designed to finance social security budget overruns. Faced with a 10.7 percent rise in spending on medicines in 2000, the French Ministry of Health cut prices of pharmaceutical products it categorized as "ineffective" to save $600 million to 700 million in order to remain within 2001 budgetary spending limits. The French government also withdrew reimbursement approval for 600 medicines, which reduced state health care system spending on medicines by more than $165 million, according to the French Committee for Health Products. Leading pharmaceutical companies, in Europe as well as the United States, have argued that prices set by the French health care system do not reflect the real costs of the most sophisticated new medicines and that France is an increasingly difficult market in which to introduce new medicines. Industry estimates suggest that foreign sales of pharmaceuticals would rise by $500 million if France removed these policies.

Italy: U.S. pharmaceutical companies complain that unnecessary delays in clinical trials slow down the regulatory approvals process and the introduction of pharmaceuticals to the market. This situation has, however, improved significantly during the last three years. In addition, National Health Service-funded pharmaceutical specialties, which have received centralized approval from the European Medicinal Evaluation Agency or obtained marketing authorizations through mutual recognition procedures, are subject to prices negotiated among the Ministry of Health, Ministry of Finance and the distributor or manufacturer. Pharmaceutical companies complain, however, that these price negotiations are lengthy and often non-transparent. Therefore, the companies may lose much of the benefit of the streamlined approvals process. Late in 2001, the Italian government issued a new health reform decree that places price caps on overall government spending for pharmaceuticals, changes the distribution of drugs to favor hospitals and clinics, and imposes reimbursement formulae that heavily favor generic formulations over market brands. These changes will adversely affect U.S. industry operating in Italy.

The Netherlands: U.S. companies have complained that the criteria used by the Dutch health insurance board 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.

Import and Distribution of Bananas

In April 2001, the United States and the EU reached an understanding in the long-standing dispute over the EU's banana import regime. The EU's new banana regime will move to a tariff-only system on January 1, 2006. In the interim, bananas will be imported into the EU under three tariff quotas with licenses allocated on the basis of historical trade. Specifically, the EU agreed to move 100,000 tons from its C quota, reserved exclusively for ACP (Africa, Caribbean, Pacific) suppliers, to its B quota (all suppliers). Thus, the B quota is increased to 453,000 tons while the C quota is reduced to 750,000 tons. The A quota (also open to all suppliers) remains at 2,200,000 tons. A GATT Article XIII waiver was granted to the EU in November 2001 to permit the continued discriminatory preference for ACP countries in the C quota. The U.S. has terminated WTO-authorized sanctions on EU products in the amount

of $191.4 million per year and will continue to monitor implementation of the EU's new banana regime.

STANDARDS, TESTING, LABELING AND CERTIFICATION

EU Member States still maintain widely differing standards, testing, and certification procedures for some products. These differences may serve as barriers to the free movement of products within the EU, and can cause lengthy delays in sales by U.S. exporters due to the need to have products tested and certified to meet differing national requirements. Nonetheless, the advent of the EU's "new approach," which streamlines technical harmonization and the development of standards for certain product groups, based on "essential" requirements, continues the general movement toward the harmonization of laws, regulations, standards, testing, and certification procedures within the EU. The United States has concerns that the European standardization and regulatory development processes lack adequate transparency and remain generally closed to U.S. stakeholders' direct participation at critical points in the regulatory development process. Standards-related and regulatory-based issues represent a growing element of U.S.-EU trade relations.

Standardization

The U.S. Government anticipates that EU legislation covering regulated products will eventually be applicable to half of all U.S. exports to Europe. Given the large volume of U.S.-EU trade, EU legislation and standardization work in regulated market segments is of considerable importance. 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 have caused concerns to U.S. exporters. These include lags in the development of EU standards; delays in the drafting of harmonized legislation for regulated areas; inconsistent application and interpretation by EU Member States of the legislation that is in place; overlap and inconsistencies among Directives dealing with specific product areas; grey areas between the scope of various Directives; and a frequent tendency to rely on design-based, rather than performance-based, standards. Such problems can impede U.S. exports to the EU. In addition, there are some problems 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.

Mutual Recognition Agreements

The EU is implementing a harmonized approach to testing and certification as well as providing for the mutual recognition within the EU of laboratories designated by Member States to test and certify a substantial number of regulated products. The EU encourages mutual recognition agreements between private sector parties for the testing and certification of non-regulated products. One difficulty for U.S. exporters is that only "notified bodies" located in Europe are empowered to grant final product approvals of regulated products. While there are some laboratories in the United States that can test regulated products under subcontract to a notified body, the limited number of such laboratories means that these subcontracting procedures are unlikely to be sufficient for U.S. exporters. Moreover, subcontracting laboratories cannot issue the final product approval but must send test reports to their European affiliate for final review and approval, which delays the process and adds costs for U.S. exporters.

The United States and the EU negotiated a Mutual Recognition Agreement (MRA) covering the following sectors: telecommunications equipment, electromagnetic compatibility (EMC), medical devices, pharmaceuticals, electrical safety, and

recreational craft. The U.S.-EU MRA is intended to facilitate trade in these sectors, while maintaining our current high levels of health, safety and environmental protection. The MRA, which entered into force in December 1998, permits U.S. exporters to test and certify their products in the United States to the requirements of the EU, and vice versa. The recreational craft annex entered the operational phase in June 2000, and the telecommunications and EMC annexes became operational in January 2001. In late 2001, both sides agreed to extend the transition periods of the medical device and pharmaceutical annexes. In June 2001, under the Transatlantic Economic Partnership (TEP), the United States and the EU initialed a separate MRA on marine equipment, which is planned to enter into force in mid-2002. In an effort to promote more effective cooperation between U.S. and European regulators, the United States and the European Commission reached agreement, in early 2002, on TEP Guidelines for Regulatory Cooperation and Transparency.

Protocols to the Europe Agreement on Conformity Assessment (PECAs)

In 2001, the European Union concluded Protocols to the Europe Agreement on Conformity Assessment and Acceptance of Industrial Products (PECAs) with Hungary and the Czech Republic. The EU is currently negotiating similar agreements with a number of other countries seeking EU membership. PECAs eliminate the need for further product testing and certification of EU-origin products covered by the agreements. Products originating in countries not party to the PECAs, even if the products have been tested and certified to EU requirements, may not benefit from these agreements. During 2001, the United States raised concerns, both bilaterally and in the WTO, that the rule of origin provision in these agreements unjustifiably discriminates against non-EU origin products and is inconsistent with WTO obligations. The European Commission initiated steps in late 2001 to drop the problematic origin provision from existing and future agreements. The U.S. Government will continue to monitor the amendment and implementation of PECAs.

Biotechnology

The breakdown in the EU's approval process for products made from modern biotechnology has hindered U.S. exports of corn and threatens trade in soya. Food processors and exporters are either reformulating or seeking non-biotech sources, and the prospect of new mandatory traceability and labeling requirements is causing enormous uncertainty in the feed and seed sectors. Problems exist for both approved products and products currently undergoing the approval process. Biotechnology continues to be more of a political than a scientific issue in Europe and prospects for improvement remain dim. Few EU Member States are willing to support a resumption of product approvals under current rules.

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, Portugal and Italy, the most significant EU importers, have stopped.

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.

Revisions to Directive 90/220 (newly revised as Directive 01/18) governing approval of biotechnology products, including seeds and grains, for environmental release and commercialization will be implemented in October 2002. Directive 01/18 is expected to be the "basis" for revision of

"Novel Food" (processed food) legislation and new legislation covering feeds and seeds. Although Directive 01/18 provides some needed clarity and sets time limits for various steps in the approval process, it is vague regarding specific rules for biotech imports.

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 that would be onerous and expensive for producers and foreign suppliers to meet. It could take more than two years to complete the co-decision process that would lead to final approval of these new Regulations. Some Member States have linked their willingness to restart product approvals to the entry into force of these new rules. Others have indicated that environmental liability legislation needs to be in place before the approvals process could resume.

Austria: Austria has imposed a marketing ban on some biotechnology products despite existing EU approvals. However, the European Commission has not initiated the necessary steps to overturn the bans even though the EU's Scientific Committee has ruled there is no justification for the ban. Austria will be introducing a regulation in 2002 under which 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 will make Austria's regulations even more restrictive than other EU members'.

Germany: Germany's nominally independent Federal Variety Office in June 2001 postponed "for further study of legal issues" an impending approval of what would have been Germany's first biotechnology products available for commercial cultivation. In January 2001, Germany indefinitely postponed the "Chancellor's Initiative," a discussion between industry and government on biotechnology policy. Citing the bovine spongiform encephalopathy (BSE - mad cow disease) crisis, the government said that consumer insecurity was too high and the timing was inopportune to address a topic as controversial as this. No significant changes in the German government's approach to biotechnology are expected before federal elections are held in September 2002.

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: Italy announced in October 2001 that it would no longer block consideration of EU market access for new biotechnology products. However, Italy has not pressed the EU to restart the biotechnology product approvals process despite the Italian policy shift. Domestically, Italy has failed to rescind its ban on four biotechnology corn varieties (BT11, MON 810, MON 809 and T25) enacted by the previous government. On December 28, 2001, the Agriculture Minister, alleging that Italian policy calls for a non-biotech food chain, issued a decree calling for a study of seeds available on the international market that could be guaranteed biotech-free.

Ban on Beef from Cattle Treated with Growth Promoting Hormones

For more than ten 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 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.

During 2001, the United States and the EU intensified negotiations on a possible temporary settlement in this dispute. Negotiations are focused on a possible lifting or phasing out of U.S. retaliatory tariffs in exchange for increased access to the EU market for U.S. non-hormone beef. Discussions are scheduled to continue in 2002. Although the EU recently published a number of new studies that analyzed the use of hormones in beef production, none of these studies presented any new evidence to support the EU's hormone ban.

Poultry Regulations

The EU continues to prohibit the use of antimicrobial treatments in poultry production to prevent transmission of bacteria such as salmonella. As a result, U.S. poultry exports to the EU have been blocked since April 1, 1997. In October 1998, the EU published a study on antimicrobial treatments, which recommends that antimicrobial treatment 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. Chlorination is the primary means employed in the United States to meet strict U.S. standards designed to ensure the safety of poultry products from microbial contamination. Recent audits by the Commission have shown that Member States are not complying with the EU ban on the domestic use of chlorinated water. In 2001, the U.S. continued to seek approvals for the use of anti-microbial treatments, other than chlorine, that could restore trade in poultry and ensure that existing markets for U.S. poultry exports in EU accession candidates are not lost as these countries complete the process of EU accession.

Transmissible Spongiform Encephalopathies (TSE) Regulations

In July 1997, the European Commission adopted Commission Decision 97/534/EC, commonly known as the Specified Risk Materials (SRM) ban. 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 spleens of sheep and goats) in any products sold in the EU.

The original date of implementation was July 1, 1998, but this was delayed several times due to controversy over product coverage. In addition to food and feed, the ban as originally proposed would have significantly adversely affected the production of pharmaceuticals, cosmetics, medical devices and fertilizers. In September 1999, the EU implemented specific regulations for SRMs on medical products for human use (Directive 99/820/EC). It also provided guidelines on how companies could comply with this Directive. Thus far, it appears U.S. companies have successfully been able to comply with it.

In June 2000, Commission Decision 2000/418/EC was adopted, which repealed Commission Decision 97/534/EC, but set 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 to remove the SRMs mentioned above, regardless of whether BSE exists in each country. 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. The EU classifies the United States as provisionally recognized as "unlikely, but cannot be excluded (GBR-2)."

In late May 2001, the European Commission adopted Regulation 999/2001, which is eventually intended to supersede all existing TSE legislation, including 2000/418. 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 SRMs, would then be applied to a country depending on the classification. In the interim, as a result of transitional measures which were passed in July 2001 (Regulation 1326/2001), only countries recognized as provisionally BSE-free are exempt from the requirement to remove SRMs in order to export to the EU. The EU currently only recognizes New Zealand, Australia, Norway, Chile, Argentina, Paraguay, Nicaragua, Botswana, Namibia and Swaziland as provisionally BSE-free.

As a country that is not in the EU's provisional BSE-free category, the United States is required to remove SRMs and Mechanically Recovered Meat (MRM) from animal products exported to the EU. The United States fully expects to be placed in a low risk category for BSE once the EU's new categorization is completed in July 2002. If the United States is re-categorized as low risk, it would not be required to remove SRMs and MRM when Regulation 999/2001 is definitively implemented. USDA has submitted information to the EU as requested under Regulation 999/2001 for evaluation and country classification. However, in the meantime, even the interim requirement related to the removal of SRMs is extremely disruptive for the U.S. industry.

Animal By-Products Legislation

The European Commission has proposed legislation that would require 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. The United States is concerned that the proposal as currently written is overly restrictive and could negatively affect U.S. exports of animal by-products not intended for human consumption to the European Union, which were valued at $525 million in 2000.

In July 2001, the EU Agricultural Council adopted a common position on a proposal articulating health rules concerning animal by-products not intended for human consumption. 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. If passed, the Animal Waste Directive will replace Directive 90/667/EEC on the disposal and processing of animal waste and amend Directive 90/425/EEC. The Animal Waste Directive has to go through a second reading by the European Parliament, expected to take place in March 2002, and will take effect six months after adoption.

As currently written, the proposal would: (1) prohibit the use of any rendered protein obtained from animal carcasses that were unfit for human consumption as an animal feed ingredient or for pet food; (2) ban the use of catering waste and yellow grease from being used as an animal feed ingredient or for pet food; and (3) create a burdensome certification and list requirement. In addition, it would prohibit feeding an animal protein derived from the same species.

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 United States has raised concerns with the European Commission that some provisions of the Directive are overly restrictive, effectively halting all U.S. exports of gelatin in June 2000. The U.S. and the EU are near agreement on a health certificate that will allow U.S. exports of gelatin to resume.

Cosmetics and Animal Testing

The EU has proposed several amendments to Council Directive 76/768/EEC governing the manufacture and sale of cosmetic products in the European Union. Some of these amendments are of concern to the U. S. government, including a proposed ban on the sale in the EU of cosmetics tested on animals where OECD-approved alternatives to animal testing exist. This ban, supported by a majority of EU Member States in November 2001, would conflict with FDA rules requiring animal testing of certain cosmetics (e.g., anti-dandruff shampoos, sunscreens, fluoride toothpaste) classified in the United States as over-the-counter (OTC) drugs in order to substantiate product safety. The U.S. Government has expressed concern that 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 U.S. The proposed amendments to the EU's Cosmetics Directive will be submitted to the European Parliament in early 2002 for a "second reading."

Chemicals

The European Commission is planning 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 system for assessing the risks of existing and new chemical substances called REACH (Registration, Evaluation, and Authorization of Chemicals). Under this new 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.

While the United States fully supports the EU's objectives to protect human health and the environment, 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 Commission is currently drafting formal legislative proposals which are targeted for completion by Summer 2002. The U.S. Government is working cooperatively with the Commission to ensure full transparency and that the views of trading partners and their stakeholders are taken into account.

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"). The EU Council of Ministers reached a "common position" on both proposals in December 2001. The European Parliament is expected to complete its second reading of the proposals in the first part of 2002.

The United States supports the drafts' objectives to reduce waste and the environmental impact of discarded products. However, the United States has expressed concerns that the proposals lacked transparency in their development and would adversely affect trade in products where viable alternatives may not exist. The proposals would, in part, ban certain materials 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 seriously consider the battery industry's draft voluntary agreement for comprehensive collection and recycling of batteries as an alternative to a ban. 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.

Belgium: In June 1999, the Belgian government submitted to the European Commission a plan to implement the EU's 1991 Battery Directive. The Belgian plan includes a ban on most cadmium-containing batteries, effective in 2008. The plan was reviewed by several statutory committees (the Federal Council for Sustainable Development, the Central Council for Economic Policy, the High Council for Public Health, and the Council for Consumer Affairs) during the second half of 1999. Work on the drafting of implementing regulations has been suspended pending the completion of a preliminary risk assessment on the production, uses and recycling of nickel-cadmium batteries.

Denmark: The Danish Environment and Energy Minister in November 2000 signed an Executive Order which as of December 1, 2000 banned 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.

Electrical and Electronic Equipment (EEE)

The European Commission is developing a draft Directive that would comprehensively regulate the product design of electrical and electronic equipment with the objective of minimizing harmful effects on the environment. It would be issued as a "new approach" Directive, outlining so-called essential requirements that could be met through harmonized European standards. Unofficial versions of the draft text have been shared selectively in Brussels and a formal proposal is expected in 2002. U.S. industry is concerned that the draft has the potential to interfere with design flexibility, delay new product development and introduction, and impose extensive administrative burdens. Industry is further concerned that the European standards and regulatory development processes are not sufficiently transparent and open to non-EU stakeholder input.

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 requires 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 U.S. business community will monitor Commission activity closely and carefully examine new directives for the impacts on business.

Austria: The government is planning to introduce a ban of hydrofluorocarbons (HFCs) in 2006. However, emission reduction regulations on products containing HFCs would take effect as early as 2002. The ban appears to exempt production of HFCs for the export market. The draft legislation would also ban certain uses of perflurocarbons (PFCs) and sulphur hexafluoride (SF6), beginning as early as 2003. The United States hopes that the Austrian government will consider alternate policy responses.

Denmark: In September 2001, the Danish government sent to the Danish Parliament's Committee for the Environment and Health for debate a revised draft of a statutory order banning the use of HFCs, PFCs and SF6 in products imported and marketed in Denmark. In the draft order, all three gasses would be phased out by 2006, with the exception of refrigeration units containing less than 25kg of HFC, HFCs in serum coolers, mobile refrigeration units (including cooling and freezing units in containers, trucks, trains and agricultural machinery), laboratory equipment, medical dose inhalers, insulating gas in electrical equipment and thermostats. Danish exports would not be affected. Due to the November 2001 general elections, the draft statutory order has not yet been debated. The new government will be reviewing the proposed statutory order. In response to the proposed statutory order, the United States government registered concern with the Danish government and the European Commission arguing that the ban would have relatively few environmental benefits due to the energy efficiency losses associated with using alternative hydrocarbons in refrigeration. U.S. industry also has underscored the potential safety concerns related to use of volatile hydrocarbons. The United States hopes that the new Danish government will reconsider the proposed ban on HFCs, PFCs and SF6.

Sweden/Finland: Effective May 1999, Sweden imposed a unilateral ban on the use of HCFCs used in refrigerator foam insulation, which effectively prevents U.S. manufacturers from shipping U.S.-made refrigerators and freezers to Sweden in the near term. Finland established a similar HCFC ban effective January 1, 2000. As these bans on HCFCs used in foam insulation are in advance of the EU-wide phase-out date of January 2003, the United States has raised concerns with the Swedish and Finnish governments , as well as with the European Commission, regarding the possible inconsistency of the unilateral ban with EU internal market provisions.

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.

Hushkitted or New Engine Modified and Recertificated Aircraft

EU Council Regulation 925/99 (the "hushkits" Regulation) took effect in May 2000. This legislation, which was allegedly aimed at reducing noise around airports, is in effect a trade barrier, and has little impact on noise. It disproportionately impacts U.S. manufacturers and airlines by limiting the registration and use within the EU of certain aircraft modified to meet the International Civil Aviation Organization's (ICAO) most stringent noise certification standards, i.e., aircraft equipped with "hushkit" noise reduction devices and those "re-engined" with engines of a certain design, all of which are of U.S. design and manufacture.

The United States has repeatedly urged the European Commission to revoke the hushkits Regulation as both discriminatory and inconsistent with the EU's international obligations, and to work within ICAO on a new multilaterally agreed noise standard. On March 14, 2000, the United States brought the matter before ICAO pursuant to dispute resolution proceedings under Article 84 of the 1944 Convention on International Civil Aviation (Chicago Convention). Proceedings were suspended for settlement discussions.

In June 2001, the ICAO Council adopted a new aircraft noise standard, and in October, the 33rd ICAO General Assembly unanimously approved a Resolution on a "balanced approach" for aircraft noise management. The ICAO Assembly Resolution gives ICAO Member States the ability to effectively address aircraft noise problems where they occur – at individual airports – in a deliberative, transparent, and measured process while providing a degree of stability to the aviation industry. This approach is based on an airport by airport "balanced approach" where each airport identifies a noise problem based on objective data, considers all available alternatives for addressing the noise issue, and selects the most cost-effective approach.

The Commission has stated its commitment to implement an ICAO-consistent noise management framework Directive and to repeal the hushkits Regulation by April 1, 2002. In November 2001, the European Commission proposed a framework Directive "establishing rules and procedures with regard to the introduction of noise-related operating restrictions at Community airports." Legislation faithfully implementing the ICAO Assembly resolution would be a positive move toward resolving the longstanding dispute between the United States and the European Union over aircraft noise.

New Aircraft Certification

The United States has worked with the European Joint Aviation Authorities (JAA) to develop procedures for validating of U.S. products for use in the European market. In fact, there are no outstanding project certification issues now pending with the JAA. France, however, continues to insist on an exception to the JAA's

decision on certification of Boeing's new model 737 aircraft. The French exception limits the seat density of aircraft sold to carriers in France. The United States continues to promote a transparent, equitable, and consistent process for aircraft certification according to the relevant bilateral airworthiness agreements.

The European Commission in 2000 submitted a draft Directive proposing the establishment of a European Aviation Safety Authority (EASA). The U.S. Government and U.S. industry have been working with the Commission, European Parliament, and EU Member States to ensure that the final legislation meets U.S. concerns so that the availability of U.S. aviation products is not impeded. The United States welcomes the potential establishment of EASA and believes it has the potential, if structured appropriately, to help overcome some past problems. The recently approved common position of the Council incorporated significant changes to the legislation that eliminated many U.S. concerns, including language that would have allowed trade considerations to play a role in what should be strictly technical safety certification decisions.

Gas Connector Hose Standard

The European standardization organization (CEN) is in the process of drafting a standard for gas connector hoses that is likely to exclude a U.S. product from the market because of design-restrictive specifications. The U.S. firm has experienced considerable difficulties in gaining access to the standardization process and has been unsuccessful in countering unfounded assertions by the CEN Technical Committee that only fixed/welded connections can be considered safe for gas hose connectors. This case represents a long-standing example of the market access barriers that European standards can create. The U.S. Government continues to raise this issue with national CEN members and Commission officials to press for more transparency and performance criteria in the CEN standardization process.

Roofing Shingles

CEN is in the process of drafting a harmonized standard under the Construction Products Directive for bitumen roofing shingles. The text, as currently drafted, is likely to exclude a durable U.S.-made product from the market because of weight specifications in the draft standard. The U.S. manufacturer cannot join the CEN working group, which is open to EU-based companies only. U.S. manufacturers will be required to obtain CE-marking on a time-consuming country-by-country basis, although a possible alternative may be through an EOTA (European Organization for Testing and Approvals) technical specification.

Anchor Bolts

In early 2001, the Commission confirmed its support for an amendment to the draft European test standard for evaluating post-installed anchors in concrete structures. The transition period for compliance with this standard (ETAG 001) will end in July 2002. The Commission has accepted the validity of complaints filed by European (and U.S.) industry that the draft standard would in effect require all anchor bolts to meet more stringent requirements associated with installation in cracked concrete. The Commission is particularly concerned that the new standard would have an adverse impact on those anchor bolts that are currently in use in EU markets and supports revisions to the ETAG 001 to accommodate anchor bolts for use in non-high-risk structures. However, to date, the problem has not been solved and the process has raised procedural questions regarding the respective responsibilities of EOTA and the European Commission.

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:

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.

Italy: Italy's interpretation of EU sanitary and phytosanitary requirements has caused, or threatened to cause, problems for the following U.S. agricultural exports: processed meat products, wood products, poultry products, game meat, ingredients for animal feed and seafood. In most cases, problems are limited to clarifying and satisfying import certification requirements that differ slightly from other EU countries. In addition, Italian imports of bull semen are restricted because of "qualitative" import standards for bull semen that favor domestic animals as well as high testing and registration fees.

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 where there is no 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 (though the restrictions remain in effect in the telecommunications sector).

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 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, 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 the Utilities Directive. However, the impact of the Communication is unclear, as it has no legal effect. Nevertheless, 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 which would expand the exemptions to the Utilities Directive for telecommunications services to all 15 EU Member

States. In a further development, the Commission has proposed a package of reforms to procurement legislation that includes a formal exemption of the entire telecommunications sector from the Utilities Directive. These new Directives are expected to be approved by the end of 2002.

Member State Practices

Some 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 is party to the WTO Government Procurement Agreement and amended its Federal Procurement Law (FPL) in 1997 to bring it in line with EU regulations. The nine Austrian provinces have also amended their provincial procurement laws. The Austrian Parliament has called on the Federal and provincial governments to unify procurement laws by August 2002. U.S. firms have reported experiencing a strong pro-EU bias, particularly in defense contracts, and offset agreements are common in the defense sector. Nonetheless, U.S. helicopter maker Sikorsky won a major procurement contract in 2000. The USG is closely monitoring for transparency a current fighter plane procurement in which a U.S. firm is participating under a Foreign Military Sales (FMS) program.

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 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 defense procurement agreements. Greece continues to insist on offset agreements as a condition for the purchase of defense items.

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 was receptive in 2001 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. In one instance, Italy cancelled an outstanding tender to allow reconsideration of selection criteria. Wider use of more competitive procedures, along with extreme care taken by

administrators in following procedures to avoid allegations of corruption (a legacy of early 1990s scandals), can cause delays in government procurement/spending. Italy recently enacted a new public works procurement bill 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 third largest aerospace company in the world.

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.

These subsidies facilitated Airbus' increase in the worldwide market; deliveries of large civil aircraft grew from 15 percent in 1990 to 38 percent in 2001, worth approximately $20 billion. In 2001, Airbus held a greater than 50 percent market share of both new aircraft orders and total order backlog for the second time in the past three years. Airbus has delivered more than 2,800 aircraft and currently has back orders of more than 1,500 aircraft.

Despite the advances that Airbus has made in the marketplace, the EU continues to subsidize the company. In 2001, the EU announced that seven of the nine EU Member State governments that have companies participating in the A380 superjumbo aircraft 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 FF 10.6 billion in loans. The German government has committed to provide DM 2 million 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 agreed to provide DM 1.3 billion to expand the facilities for Airbus at the EADS Hamburg-Finkenwerder airfield plant, and French national and local authorities plan to provide FF 3 billion 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 US-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. Bilateral discussions with the EC in 2001 produced mainly general information about the scope and nature of government support for the A380. The United States has requested further detailed information.

Government Support for Airbus Suppliers

Belgium: The government of Belgium and Belgian regional authorities subsidize national aircraft component manufacturers (the Belairbus/Flabel consortium) which supply parts to Airbus. In November 2000, the Belgian national government reached an agreement with the three regional governments responsible for aviation research and development on a Euro 195 million ($221.6 million) package for the development of the Airbus A380. Although the regional governments of Wallonia, Flanders, and Brussels are usually responsible for industrial assistance, this authority has been returned to the national level for the A380 project. There is concern that these subsidies may be inconsistent with the 1992 Trade in Large Civil Aircraft Agreement and/or the WTO Agreement on Subsidies and Countervailing Measures.

Belgium states that it has discontinued an earlier exchange rate subsidy program that appeared to be similar to a German exchange rate guarantee program that was found to violate GATT rules. The United States has sought information on the Belgian program and is continuing to monitor the issue.

Sweden: The government of Sweden is currently negotiating loans or guarantees with Swedish Airbus participating companies Saab and Volvo. The negotiations continued throughout 2001 and are expected to conclude early in 2002. The Swedish government stated that any agreement reached will be in compliance with the 1992 bilateral Agreement on Large Civil Aircraft.

Government Support for Aircraft Engines

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. As required under EC regulations, the UK Government notified the proposed aid to the European Commission for review under Article 87 of the Treaty of Rome.

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 EU adherence to the SCM Agreement. U.S. engine

suppliers have lost sales of engines and claim that they have encountered suppressed prices in the U.S. and world markets.

The European Commission recently made available its final written decision on the 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 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 implementation of the Directive by Member States will allow for EU ratification of the WIPO "Internet" Treaties (both the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty).

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 rights-holders; 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. In an effort to introduce more reasonable costs, the European Patent Office (EPO) reduced fees for filing by 20 percent in 1997.

European Community Patent: U.S. business and industry are largely in favor of the proposed European Community (EC) patent that the EU intends to establish. 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. However, internal Commission disagreement has blocked progress on this project.

Patenting of Biotechnological Inventions

On June 16, 1998, after years of debate, the EU adopted a Directive 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.

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 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 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. Subsequent bilateral discussions took place in 2000 and 2001. To date, the EU has not amended Regulation 2081/92 to address any of the U.S. Government's concerns.

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: Pre-video release piracy in Belgium has caused an estimated loss of $12 million to the U.S. motion picture industry in 2001. Efforts to combat this piracy are hampered by slow enforcement procedures. Levies on blank tapes and recording equipment are collected to compensate rights holders for the private, home copying of their works and to provide a source of funding for local productions. These levies are distributed by national collecting societies to the various categories of rights holders according to statutory provisions. However, the U.S. motion picture and recording industries have not been able to collect their share of these proceeds.

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. Counterfeit cassettes are marketed as legitimate products and sold in open-air markets, especially along the Polish and Czech borders. 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. The unauthorized parallel importation of DVDs from the United States Canada, and Asia, even by large retail chains, has emerged as a significant and growing problem. Pirate smart cards and decoders used to receive satellite signals illegally continue to present a problem for pay-television programming. German magazines and websites regularly advertise illegal smart cards. U.S. industry estimates that it lost $50 million due to audiovisual piracy in Germany in 2001.

German IPR enforcement measures are quite strong. However, legislation, in particular the Copyright Act, does not cover the illegal reception of transmissions and, as a result, there is no recourse against the manufacture, distribution, or use of devices that permit such reception. The German government is in the process of preparing legislation to implement the EU's Conditional Access Directive, which will apply to access control devices and should address this shortcoming.

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, fearing that this could 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 still pending.

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 such 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 is expected to present a bill to parliament in September or October, 2002.

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 United States continues to monitor developments with respect to the Broadcast Directive, which is scheduled for revision in 2002. The Commission is expected to release its consultation document on the revision to the Directive in the first half of 2002. The United States is particularly concerned about EU accession negotiations, where acceding countries appear to be required to apply more restrictive rules in this sector than current EU Member States.

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 in particular limit the access of U.S. programs to the lucrative French prime time 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 rights holders 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 15-20 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: In 1997, the Spanish government adopted implementing regulations for the 1994 Cinema Law, which reserved a portion of the theatrical market for EU-produced films. Thanks to successful industry-government negotiations, the new regulations eased the impact of the 1994 law on non-EU producers and distributors in regard to screen quotas and dubbing licenses. The screen quotas finally adopted required 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, the Spanish Parliament adopted new legislation that maintained the film screen quotas. The new law notes that the screen quotas may be eliminated in five years.

Postal Services

U.S. express and package service providers remain concerned that the prevalence of postal monopolies in many EU countries restricts their market access and subjects 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. Additional liberalization would occur in 2006. Proposed legislation is being considered by the European Parliament.

Belgium: American firms are focusing 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.

Germany: In 2001, the European Commission ruled against Deutsche Post (DP) in two complaints brought by competitors, including a U.S. firm. The first decision, in March, found DP to have abused its dominant market position by granting fidelity rebates and engaging in predatory pricing in the business parcel services market. The Commission also ordered DP to pay a fine of 24 million Euros and to separate its business parcel services from its basic services to prevent cross-subsidization. In July, the Commission ruled again against DP, confirming that the company had blocked the delivery of mailings from within the EU. The fine in this case was a symbolic 1000

Euro. The German government in July also decided to extend DP's letter monopoly until 2007, thus extending its exclusive service by an additional five years beyond the period foreseen in the German Postal Law of 1997.

The most important complaint to the European Commission by a U.S. firm in 1994 alleging state aids is still pending. The firm maintains that continued delay in reaching a decision in this case further exacerbates the anticompetitive market situation. Many observers believe that the German government has attempted to delay the Commission's decision.

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 lawyers in Denmark cannot offer advice to international clients on international issues without being a member of the local bar. Foreign lawyers and law firms face other restrictions on whom they can advise and on the use of the firm name in the law firm's home country.

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 an "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 member states 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 states that are not 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 legislation calling for the pan-EU liberalization of legal services. Sole-practitioner EU lawyers may now practice in Italy simply by observing local rules and joining a local bar association. EU lawyers looking to practice together in Italy must form a "societa tra avvocati" ("company of lawyers"). The status of non-EU lawyers is not expressly addressed by the law and, arguably, they are ineligible for membership in a "societa tra avvocati." This leaves the status of many non-EU international law firms with offices in Italy uncertain.

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.

Denmark: Foreign accountants cannot form partnerships with Danish accountants or hold majority shares in accounting firms without special authorization from Danish authorities. There is a scope of practice limitation. A public accountant is not permitted to act as a liquidator or to arrange for a composition with creditors.

France: There is a nationality requirement for establishment, 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

Since the late eighties, there has been a general trend toward increased competition and openness in European telecommunications. Liberalization has been driven primarily by the desire to create a single European market in telecommunications and to gain the benefits from the globalization of the telecommunications sector. The negotiation of the

1997 WTO Basic Telecommunications Agreement (BTA) provided additional impetus for liberalization and ensured the extension of benefits to third countries, including the United States. Under the WTO Agreement, all EU Member States made commitments to provide market access and national treatment for voice telephony and data services. The EU and its Member States also adopted the pro-competitive regulatory principles set forth in the WTO Reference Paper.

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" while a 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 long term 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.

Both the WTO Basic Telecommunications Agreement and newly proposed EU legislation have spurred deregulation. However, liberalization and harmonization have been uneven across the EU. 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.

The European Commission monitors and reports regularly on implementation of the current regulatory framework by the Member States. The most recent report (the Seventh Implementation Report) highlights continuing progress in opening the European market to competition and consequent growth of the sector. The Report can be found on-line at: *www.europa.eu.int/information society/topics/telecoms/implementation/index.en .htm*.

According to this report, the long distance prices of incumbent operators have dropped 11 percent since 2000, principally as a result of increased competition. Prices within the EU are also beginning to more closely reflect the cost of providing service. The market share held by incumbents has fallen 10 percent for local calls, 20 percent for long distance calls, and 30 percent for international calls since liberalization began. Market shares of leading mobile operators have also decreased as a result of competition.

Regarding interconnection, the European Commission found that the price of terminating calls from fixed to mobile networks could not be justified in terms of actual costs, and that a flat rate connection for Internet access should be encouraged. Regarding leased lines, the Commission believes that high prices and lengthy lead times for connection across the EU could not be justified by differing costs or conditions. The Commission determined more generally that the Telecommunications National Regulatory Authorities (NRA) within Member States needed to exert authority more aggressively to control

incumbent operators' behavior, particularly in local loop unbundling. It also found that the National Regulators could be more effective at resolving disputes between new market entrants and incumbent operators as a means to speed provisioning of broadband services.

Enforcement of existing legislation by National Regulatory Authorities 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.

Specific Member State Practices

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 have raised concerns that Belgacom, the dominant telecommunications supplier, is opposed to the unbundling of the local loop. Belgacom remains the de facto monopolist for Advanced Digital Subscriber Line (ADSL), despite the introduction of some regulations for the liberalization of the local loop.

Moreover, concern remains 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. Despite the Belgian government's announced intention to further privatize Belgacom, 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 telecom 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.

Although the Finnish government has announced its intent to fully privatize its telecommunications incumbent, Sonera, it has not yet sold the state's 52.8 percent stake in the company.

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 U.S. and other competitors about leased-line pricing and provisioning, the ART forced FT to lower its interconnection offer for 2002, with prices set to fall by 6 percent for local calls, and 23.5 percent for national long-distance calls. Starting December 31, 2001, FT must also allow carrier preselection for local calls (as is already the case for long distance calls), thus establishing local-call competition. In addition, addressing another long-standing complaint by competitors, the ART decided in November 2001 to make fixed to mobile termination rates more cost-oriented, lowering them a further 40 percent over three years.

The record remains mixed on liberalizing the high-speed Internet market. Unbundling became effective January 1, 2001, and some of the six companies that have contracted with FT to install their ADSL equipment on its lines have started offering high-speed services to business customers. However, throughout 2001 FT maintained a variety of entry barriers, such as high costs for co-location and bitstream filtering which, combined with its dominant position in ADSL services, hindered competitors from offering direct residential services.

Germany: Germany has made significant progress in introducing competition to its market. However, new entrants continue to face difficulties competing with the incumbent Deutsche Telekom AG (DT). The Regulatory Authority for Telecommunications and Posts (RegTP) issued a number of pro-competitive rulings during 2001, but the incumbent challenged virtually all of them, which led to extensive delays in implementing these otherwise positive decisions. In August, a court ruled that DT had abused its dominant market position and had to take steps to share lines in order to allow competitors providing Digital Subscriber Line (DSL) services into the market. In October, the same court reaffirmed a regulatory decision from February regarding "reselling," which required DT to make its last mile available to competitors for voice and data services. These decisions ended months (in some cases more than one year) of legal uncertainty, but 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.

Throughout 2001, competitors charged that DT continued to engage in a variety of anticompetitive practices. In January 2001, 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 were serious problems; DT was not providing timely access to co-location space; DT's unbundled rates were not cost-oriented; and that wholesale flat-rate interconnection rates for Internet access are high and not cost-oriented. A German court in September 2001 ruled that the cost of telecommunications licenses and other fees were too high, thus reducing this longstanding barrier to entry. The ruling will take effect in 2002, or almost two years after the government pledged to resolve the problem. The new license fee structure will bring Germany into line with EU law, which requires that licensing fees be cost-oriented and reflect administrative costs.

Ireland: Over the past five years, the Irish government has made significant progress in liberalizing the telecommunications sector, with a commitment to full competition since December 1998. 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 (80 percent share) and leased line services and national interconnection. Thus, while there are currently 80 licensed operators in the Irish market, 47 of which are active, these new entrants only account for 19 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 largest, Eircell (formerly a subsidiary of Eircom and now owned by UK-based Vodafone), enjoys a 60 percent market share. 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) has set a tariff rate for the "last mile," which is under challenge by Eircom in the Irish courts. The ODTR's regulatory effectiveness is hampered by lack of enforcement authority and clearly defined objectives, and the Irish government is considering legislative options to give ODTR more regulatory authority.

Italy: The Italian telecommunications market has made substantial progress toward full liberalization. Fixed telephony is fully open to competition, with more than 80 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 owns a golden share that enables it to influence (or veto) 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 many other participants in telecommunications consortia operating at the national level.

Spain: Spain has attracted significant interest from new entrants. A number of U.S. companies successfully participated in the auctioning of spectrum licenses held by the Spanish government in March 2000, and, after a recent shakeout of the sector, currently hold interests in two of five LMDS (local multipoint distribution service) operators. LMDS is a digital wireless transmission system, also known as a wireless local loop, designed to provide the "last mile" from a carrier of data services to a large building or complex that is not wired for high-bandwidth communications. Within a little more than six months after the signing of the licenses, the regulator increased its fee for use of the spectrum by more than 13 times the original amount, effective January 1, 2001. This dramatic increase in the spectrum fee placed at risk not only the guarantees posted in the form of performance bonds to secure the licenses, but also the significant investment made by U.S. investors, both totaling in the tens of millions of dollars. The Spanish government's annual budget for 2002 reduces this spectrum fee charge by 92 percent from the 2001 rate. While this charge is more in line with rates across Europe, it still leaves operators owing a great deal of money to the government for the 2001 charges, placing their investments at risk.

During 2001, the Spanish government unbundled the local loop with the expectation that it would result in increased competition, thus benefitting consumers through lower prices and more value added services. However, implementation has been problematic. Although the incumbent 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. The Reference Interconnection Offer regarding local loop unbundling from Telefónica has significant problems. Competitors that have tried to negotiate non-discriminatory 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 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 binder management rules that are managed by Telefónica, as opposed to standards-based rules (and a resumption of compatibility) or spectral density masks.

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. The telecommunications regulator, OFTEL, took steps during 2001 to respond to competitors' complaints about BT's foot-dragging, ruling that BT must offer guaranteed service levels and access to its telephone exchanges to rivals. However, one year after the EU mandated the unbundling of incumbents' local loops, the UK has less than 200 such lines in operation. Competition in high-speed services is emerging, however, with cable television companies offering lower-priced broadband access over their own infrastructure. The government has stated that it aims to become the leader in broadband services among G-7 countries by 2005, and is currently evaluating a number of options to achieve that goal.

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 among both EU Member States and Member States 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). The U.S. has also conveyed to the EU its concern that U.S. bilateral

investment treaties with countries now negotiating to join the EU not be adversely affected by the enlargement process.

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. U.S. firms' right 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, that affect national defense, public safety, or public health. The government is able to exert influence over privatized firms through "golden share" provisions. 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 secondly, 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 both 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, they 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.

U.S. and other non-EU investors receive less advantageous treatment than domestic or other EU competitors in the banking, mining, maritime, air transport and broadcast industries (which were opened to EU citizens due to EU single market rules). Extensive red tape and contract delays also are major impediments to U.S. investments in Greece. There are restrictions for non-EU investors on land purchases in border regions and on certain islands (on national security grounds).

Portugal: Most foreign investments in Portugal are only subject to *post facto* registration. However, Portugal retains the discretion to limit foreign investment in state-owned companies being privatized on a case-by-case basis. 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 grandfathered, which means that firms can carry on without needing to re-apply for permission or approval.

ELECTRONIC COMMERCE

The EU is working to accelerate the utilization of digital technologies by business, consumers and governments. The "eEurope Action Plan" is meant to build a cheaper, faster and more secure Internet; increase European skills and access; and stimulate use of the Internet. Neither the Internet nor electronic commerce (e-commerce) at the business and consumer level is as widely used in Europe as in the United States but considerable growth is expected in the next few years, and signs of that growth are already beginning to appear. For example, households with Internet access increased from 28 percent to 36 percent between October 2000 and June 2001. Follow-up to the eEurope Action plan includes benchmarking exercises and ongoing attention at European Summits.

The eEurope Action Plan includes a Directive on electronic signatures which sets out a framework for legal recognition of electronic signatures and includes mechanisms for cooperation with non-EU countries, including on the basis of mutual recognition.

A Directive addressing the legal aspects related to electronic commerce came into force in January 2002. The Directive is designed to ensure that electronic commerce benefits from the internal market principles of free movement of services and freedom of establishment. Covering only providers established in the EU, it establishes harmonized rules in a number of areas such as liability of intermediaries (e.g., Internet service providers), transparency provisions for commercial communications, and electronic contracts.

Updating the Brussels (1968) and Rome (1980)

Conventions covering jurisdiction and applicable law respectively to allow consumers to take legal action in their home countries courts in matters concerning intra-European e-commerce has attracted considerable attention. The Regulation updating the Brussels Convention is expected to take effect in March 2002.

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. Business representatives claim that foreign suppliers still face legal uncertainty regarding the Austrian e-commerce law to implement the EU e-commerce directive, even though it enters into force in 2002. The specific Austrian regulation that consumers must "opt-in" to receive unsolicited information (instead of having an "opt-out"-choice) is another Austrian regulation that may hamper the development of e-commerce.

Data Privacy

Data privacy retains a high profile in transatlantic relations. There are two relevant EU Directives: a horizontal Directive on Data Protection that was adopted in 1995 and took effect in October 1998, and a telecommunications-specific Data Privacy Directive that was adopted in 1997 and took effect in October 2000. Several Member States have yet to implement these directives, 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.

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; its ultimate impact on U.S. service providers remains to be seen.

Taxation of Electronic Commerce

In December 2001 the EU Council of Ministers reached political agreement on a proposed Directive on the taxation of electronic commerce. EU Member States have agreed that no new or additional taxes should be imposed on electronic commerce, but rather 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 this year, 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.

OTHER BARRIERS

Canned Fruit

Damage to the interests of the U.S. canned peach industry caused by EU domestic support programs is a long-standing issue. Since Greece joined the EU in 1981 and began receiving EU subsidies for canned peaches, the U.S. canned peach industry has lost significant market share to Greece in third countries. In response, the California Canning Peach Association filed a Section 301 petition. As a result, the U.S. Government took the case to a GATT panel and won a favorable decision in 1984. This decision facilitated the negotiation of the U.S.-EU Canned Fruit Agreement (CFA) in 1985. Although the CFA brought some discipline to processing subsidies, significant fraud and abuse undermined the discipline imposed by the Agreement.

In July 2000, the European Commission proposed a reform of the processed fruit and vegetable sector, including canned peaches, which was passed by the Council in November and published in December 2000. Under the old regime, processors received aid as compensation for paying growers a minimum price. Under the new regime, the processor aid and the minimum grower price are eliminated, and a per-ton aid instead is paid directly to producer organizations such as cooperatives. There are both national and EU-wide quotas that, in theory if exceeded, would result in an aid reduction the following year, but the current quotas appear too high to be exceeded

except in extraordinary circumstances.

Because the new aid regime changed the procedures for establishing the aid levels for canned fruit, the United States held consultations with the EU in December 2000 under the Canned Fruit Agreement. EU shipments of heavily subsidized canned peaches continue to distort world markets to the detriment of U.S. producers. In November 2000, USTR also asked the U.S. International Trade Commission to report on EU policies in the horticultural sector, including processed peaches, that effect the competitive position of U.S. producers. The U.S. Government will continue to work toward resolution of this issue.