

# Transatlantic Cooperation In Managing The World Trading System: New EU-U.S. Arrangements To Strengthen Liberal Multilateralism

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## **Introduction**

In the past year, in the context of the fiftieth anniversary of the end of the Second World War, leaders on both sides of the Atlantic have been championing initiatives to deepen EU-U.S. trade relations. Some have called for increasing joint work by civil servants and ministers in Washington and Brussels on specified EU-U.S. trade issues; others have called for the negotiation of a Trans-Atlantic Free Trade Agreement (TAFTA); still others for a EU-U.S. "economic zone" that reduces both tariff and non-tariff barriers to trade. U.S. Secretary of State Warren Christopher, USTR Mickey Kantor, EU Commission President Jacques Santer, and EU External Economic Affairs Commissioner Sir Leon Brittan each support deeper trans-Atlantic integration, partly to enhance efficiency and consumer welfare, but mostly because the bilateral relationship needs an infusion of inter-state cooperation in light of the dissolution of the Cold War glue that has helped bind together Europe and the United States. No doubt they are right.

But the argument for renewed trans-Atlantic cooperation on trade should be based on a more complete analysis of strains on the international trading system. And the prescription for trans-Atlantic trade cooperation should reflect that broader analysis. In short, it is argued here that deeper trans-Atlantic trade integration and cooperation should be designed to improve management of the world trading system.

Part I of this Working Paper argues that trans-Atlantic trade tension is only part of a bigger picture. Since the early post-War period, the system has been evolving slowly from U.S.-led liberal multilateralism to become increasingly fractured, strained, and competitively regional. The liberal multilateral system is strained by its failure to address chronic trade problems with Asian national economic systems organized very differently from those in the West, the challenge of more fully integrating transitional economies into world trade, and concern about how the developing countries should be woven into the system. The rapid establishment of new regional trade arrangements, and successive rounds of deepening in older ones, are fracturing multilateralism. The tensions that need to be addressed are not just between Europe and the United States; they involve several economic groupings and powers.

Among the world's great economic powers, the European Union and the United States uniquely share a common interest in preserving a liberal multilateral trading system in the face of these strains and fractures. Part II argues that they will satisfy that interest only through cooperation and coordination that has proven crucial to managing the multilateral system in the

past. For example, EU-U.S. cooperation and coordination proved its effectiveness in closing the Uruguay Round: by withdrawing from the old GATT and joining the WTO (with its new GATT), the trans-Atlantic powers forced the rest of the world to join the WTO (and all the associated Uruguay Round Agreements) or lose their most-favored-nation (MFN) access to Europe and the United States, which no GATT contracting party could afford.

Part III argues that Europe and the United States face serious problems in efforts at trans-Atlantic cooperation and coordination. Bilateral differences-- not common interests-- tend to dominate the trans-Atlantic trade dialogue. A prisoners' dilemma often confronts each power-- the European Union and the United States-- when they engage in a common dialogue with third countries: each is tempted to cut its own preferential deal instead of a coordinated deal. For example, in the recent auto dispute with Japan, EU negotiators infuriated their U.S. counterparts when they reached a separate arrangement with Japan that some have suggested included a promise to attack the U.S. unilateral approach in the WTO; EU negotiators reportedly were then upset by the subsequent U.S.-Japan deal, which they interpreted as discriminatory. Moreover, when pursuing a separate dialogue with a third country, each power is loathe to conclude an agreement consistent with the MFN principle, because it will have expended its own negotiating power on an agreement with benefits that accrue to all-- a public goods problem. Witness U.S. frustration when-- after the EU had refused U.S. requests to help negotiate increased intellectual property protection in China-- EU diplomats traveled to China to ensure that benefits of the U.S.-negotiated intellectual property agreement would accrue to Europe.

Part IV argues that deeper trans-Atlantic integration (open conditionally to third countries), and other new trans-Atlantic mechanisms and institutions, would help solve these problems and reinvigorate EU-U.S. trade cooperation. Trans-Atlantic arrangements should try to deepen EU-U.S. integration-- effectively converging the two powers' positions on trade issues-- but they should also be structured to reorganize the way the trans-Atlantic powers address common problems with third countries and manage the multilateral trading system.<sup>1</sup> Those mechanisms should maximize the chances for multilateralizing any EU-U.S. deep integration

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<sup>1</sup> Thus far, this latter set of goals has received only secondary consideration-- at best-- by EU and U.S. leaders. The objective of improving trans-Atlantic trade cooperation in the WTO and on problems of common interest in third countries received more serious (though not central) attention in Canadian Trade Minister Roy MacLaren's May 22, 1995 speech to the Royal Institute of International Affairs and in the recent EU Commission Green Paper, "Europe and the U.S.: The Way Forward."

arrangements; at a minimum, EU-U.S. trade arrangements should be open for accession to third countries willing to undertake their obligations and otherwise pay the price of admission.

A Trans-Atlantic Economic Area (TEA)-- a trans-Atlantic agreement to eliminate tariffs, non-tariff barriers, and address deeper trade-related policies such as subsidies, intellectual property protection, investment measures, services, competition policy, etc.<sup>2</sup> -- will not be created overnight. Agricultural issues make it difficult to conclude either a TAFTA or a TEA in the short term.

Nonetheless, Part V argues, important steps may be taken to deepen EU-U.S. integration, reduce fractures in the system, and improve trans-Atlantic management of the world trading system. Those steps, which are detailed below, include reaching bilateral understandings on: (1) some "win-win" topics that will reduce bilateral tensions, such as mutual recognition of product testing and certification; (2) "rules of the road" for EU- and U.S.-centered regional trade regimes, perhaps reducing the future adoption of new trade-diverting preferential regional rules of origin and other tension-producing provisions, and minimizing inconsistencies between the two sets of regimes with a view to eventually joining them together; (3) competition policy, investment policy, and other topics not currently addressed by the WTO that can be structured to induce third countries to adopt similar rules; (4) coordinating EU-U.S. negotiations with third countries; and (5) jointly managing the WTO.

### **I. The Geoeconomic Context of Trans-Atlantic Trade Relations: Common Interests in Reducing Strains and Healing Fractures in The World Trading System**

Just after the Second World War, with the world split into two blocs, and the United States dominant economically and militarily in the West, the United States was able to build a Western trading system in its image. The United States tabled the text that became the General Agreement on Tariffs and Trade (GATT). That text constructed a liberal multilateral system, built largely on assumptions that the constituent economies were structured similarly to that of the United States-- that they were Western liberal economies, composed of price-sensitive, profit-maximizing firms, and with little government intervention except for purposes of solving market failures such as the provision of public goods and competition policies intended to ensure

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<sup>2</sup> This agreement would cover topics similar to those in NAFTA and would be similar to what Sir Leon Brittan has called "an EU-US economic space."

that sectors remained relatively unconcentrated. GATT rules acknowledged that state enterprises, subsidies, and other non-liberal governmental intervention might play a role in some economies, but the GATT-system did not contemplate that those features would be anything other than exceptions. This system made sense as long as the constituent economies were essentially liberal: liberal multilateral rules affected liberal economies similarly.

The structure of world power and the world economy are very different today: the East-West security overlay is gone and economic power has dispersed-- the United States, the European Union, Japan, and China each have imposing elements of economic power. Moreover, national economic systems structured very differently from those envisioned in the Western liberal model are increasingly important actors in the world trading system. Reflecting those underlying power changes and the broader scope of national systems, the world trading system built in the U.S. image is suffering significant strains and lines of fracture.

Several Asian economies, with industrial structures and government-business relationships that are fundamentally different from those in the West, pose serious challenges to the WTO system. Strong industrial policies in some of these Asian economies have denied benefits to the West expected from their tariff concessions. And weak competition policies in these Asian economies, mirroring concentrated industrial structures and inaccessible distribution systems, have served to limit imports and enable discrimination. In conjunction with macroeconomic savings and investment imbalances, these policies may help explain chronic trade imbalances-- particularly in specific sectors-- between the United States and Europe, on one hand, and Japan, for example, on the other, regardless of whether the yen has been at 250 or 100 to the dollar.<sup>3</sup>

At the same time, the WTO system's rules do not fully address developing country issues. Many thoughtful policy-makers in the United States want to integrate the developing countries more fully into the liberal trading system, largely for political purposes: to enhance the prospects for democracy and to "lock-in" those countries while they are in the midst of economic and political liberalization. But the effort faces problems. Unstable macro-economic histories in some developing countries limit business support for further integration. Many developing countries have a relatively weak administrative and legal infrastructure, making it difficult for

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<sup>3</sup> The regionalization of the keiretsu system in the face of endaka may be simply offshoring Japan's chronic trade imbalance with the West to the rest of Asia.

them to administer and adjudicate customs issues, intellectual property protection, environmental protection, labor protection, and other Western-style regulatory systems that are now seen as important trade-related issues by various groups in Europe and the United States. Moreover, level of development affects the value that polities place on building and maintaining such systems. At the same time, the GATT's MFN principle, combined with the developed countries' political need for reciprocity, makes it difficult for the developing countries to bargain successfully for tariff concessions that favor their products. As a result, North-South tension at the GATT/WTO persists and efforts to more fully open trade with developing countries faces serious obstacles.

And now the transitional economies of China, the former Soviet Union, and Eastern Europe are entering the world trading system and posing new challenges to it. State economic authorities, which still play an important role in most transitional economies (e.g., in the form of state enterprises, state trading enterprises, and trading rights schemes) inevitably make decisions that are based on considerations other than price and may non-transparently defeat the GATT cornerstones of MFN, national treatment, tariff concessions, and quota bans.<sup>4</sup> The relative weakness of legal systems and central government authority in the transitional economies makes compliance with WTO rules difficult. At the same time, political and social dislocations in those countries require a delicate balance between liberalization and continuity.

With so many different interests and national economic systems represented at the multilateral bargaining table, and with economic and political power so much more dispersed than it was at the founding of the GATT-system, it is not surprising that multilateral progress has been moving to face these broad and fundamental challenges at a glacial pace. The Uruguay Round was a great victory for world trade but it does not instill confidence about the ability of the GATT/WTO system to respond quickly or fully to new issues facing the system: the U.S. Government identified issues for multilateral resolution in 1980; first proposed a new round a year later; saw the Uruguay Round launched in 1986; struggled towards conclusion for almost a decade-- until 1994; and will have to wait for even partial solutions to key problems like agriculture and intellectual property protection to be implemented after the year 2000. More than

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<sup>4</sup> For example, decisions by state trading enterprises (STEs) or import licensing authorities to limit imports can defeat the GATT's ban on quotas; decisions by STEs on the domestic resale price of imports can defeat the GATT schedule of concessions; state enterprise decisions to favor domestic producers (or a particular foreign country's producers) over the lowest cost product (regardless of origin) can defeat the national treatment principle (or the most-favored-nation principle).

twenty years will have passed from trade problem identification until partial multilateral solution. And the next round of challenges is not any simpler.

Partly in reaction to frustration at the multilateral level, and partly in response to the preferences made possible by free trade agreements, many countries have turned to regional trading schemes. The consequent regional trade groupings, and the emergence of competition between them, are further straining the WTO system. Forty years ago, the GATT Article XXIV exception to multilateralism, permitting the establishment of free trade areas and customs unions, was viewed positively: it allowed formation of the European Communities, which the United States originally favored as part of the bulwark against the Soviet Empire and as a means of embracing and containing West Germany.

Now it's not as clear that Article XXIV is good policy, even though it's too late to do much about it. The Cold War rationale for the EC is gone, leaving those outside Europe with constant concern about Brussels' designs. Moreover, now the European Union is joined by NAFTA, APEC, the FTAA initiative, ASEAN's AFTA, and MERCOSUR, each diverting (or threatening to divert) some trade and investment from countries outside its boundaries-- much to the political chagrin of those countries. Preferential rules of origin intended to enhance trade and investment diversion exacerbate the associated political tension. The bigger players are engaging in a race reminiscent of the Colonial period to build their preferential systems: the European Union builds concentric circles of preferences, adding members, countries linked through association agreements, free trade agreements, and Lome Convention preferences; the United States moves to expand NAFTA, build an FTAA, and enhance the meaning of APEC; both powers compete to try to engage MERCOSUR, other Latin American countries, China, and the rest of Asia. Each time a free trade agreement is concluded or expanded, those left outside express concern and complain; witness the endless EU-U.S. disputes for GATT Article XXIV compensation every time the European Union expands.

There are disturbing trends away from U.S.-led liberal multilateralism to a system facing increasingly serious strains and fractures and experiencing some elements of competitive regionalism. The trading system does not face imminent collapse; there are crucial economic, political, and security interdependencies that are keeping the system together. But if left unchecked it does not take great imagination to see trade-related diplomatic tensions rise and political dissatisfaction with the multilateral system grow to levels that endanger it.

## **II. The Benefits Of Enhanced Trans-Atlantic Trade Cooperation For Managing The World Trading System**

Enhanced trans-Atlantic trade cooperation could provide a basis for reducing strains and healing fractures in the system. Increased bilateral trans-Atlantic trade cooperation will slow trans-Atlantic drift in the international political-economic system. EU-U.S. trade disputes are more nerve-racking now that the Cold War glue is gone and that tension needs to be resolved through a renewed focus on how to cooperate on the trans-Atlantic powers' bilateral trade disputes with each other. Moreover, while NATO's persistence should and will undoubtedly turn on common security concerns, a reduction of trans-Atlantic trade tensions will eliminate a potentially confusing peripheral factor from popular consideration of the alliance's future. And resolution of bilateral trade tensions will facilitate greater cooperation on common problems, including management of the multilateral system.

Enhanced trans-Atlantic cooperation is also crucial to solving common problems with third countries and managing the WTO system. Europe and the United States uniquely share many of the same interests in solving common problems with Asian economies whose industrial structures and government-business relationships are fundamentally different from those in the West, integrating the transitional economies into the world trading system, and solving trade problems with developing countries. Moreover, the best solution to the apparent contradiction between multilateralism and regionalism might be provided by enhanced trans-Atlantic cooperation. Some U.S. trade analysts have argued that regional trade groupings could serve as "stepping stones" to multilateral liberalization, with regional liberalization somehow "ratcheting upwards." Any ratcheting process must logically entail trans-regional liberalization, and any trans-regional agreement to liberalize will require that both regions enjoy a net gain from the liberalizing rules.<sup>5</sup> The European Union and the United States are the most logical candidates for trans-regional liberalization: their respective national economic systems, based on a Western liberal model, are similar, making it relatively easy for them to agree to common trade rules between each other and to coordinate their positions in multilateral trade negotiations, or negotiations with other regional or national economic systems. Their interests largely coincide. In contrast, the APEC exercise in trans-regional liberalization faces obstacles that will be

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<sup>5</sup> The alternative would be that one region imposes its structure of liberalization on the other, an unlikely scenario in a world with relatively dispersed economic power.

relatively difficult to overcome: the three largest APEC powers (China, Japan, and the United States) must develop a set of rules that intermediate trade between national economic systems that are organized in fundamentally different ways. A EU-U.S. deal would be the easiest of the trans-regional deals that could be made.

The combined and coordinated economic and political capacity of Europe and the United States-- deriving from the size of their markets-- could then serve to help multilateralize the liberalizing rules negotiated between them. Trans-Atlantic coordinated action offers a greater probability of successfully resolving trade problems with third countries than is offered by the independent action of either power. Trans-Atlantic cooperation in closing the Uruguay Round attests to that.

### **III. Problems Facing Trans-Atlantic Trade Cooperation**

For the past few decades, Europe and the United States have organized their trade relations and cooperation on common trade problems through summit meetings (now regularly scheduled), trans-Atlantic cabinet meetings (which used to be regularly scheduled), relatively frequent ministerial and sub-cabinet meetings, normal diplomatic channels, ad hoc bureaucratic contacts, and plurilateral vehicles such as Quadrilaterals, G-7 meetings, and OECD activity. This approach has constituted a legitimate and broad trans-Atlantic trade dialogue that has often successfully resolved trade issues. But it also has shortcomings-- described below-- that might be eliminated if cooperation were undertaken through alternative mechanisms.

Under the current approach, bilateral trade disputes are usually raised one at a time, usually in reaction to a trade measure taken by one side or as an existing practice rises in political importance. Treating each issue independent of others forgoes the possibility of cross-issue linkages that can turn a single-issue zero sum dispute into a positive sum gain for both sides. Moreover, raising the issues in reaction to a trade measure, or as an existing practice becomes politicized, ensures that bilateral problems will be tough to resolve. Ultimately, the two sides simply agree to disagree and let time manage their problems. It is therefore not surprising that the list of unresolved bilateral trade issues in each power's dossier on the other seems to grow over time: U.S. chicken-war tariffs are still in place from the 1960s; beef hormone retaliatory tariffs on European tomato paste stand; agricultural policy disputes are not resolved but merely in a cease-fire "peace treaty" period; tension over the Broadcast Directive will not go away; trade

diversion effects of regional rules of origin remain a thorn in the side; EU expansion compensation issues persist; and product standards raise trouble. The European Union and the United States have agreed to disagree so many times that they now seem to disagree on a lot.

In trade disputes that both powers have with third countries, particularly Asia, the absence of more regularized or institutionalized cooperation leads to a set of different problems. Not only do the two powers rarely act in concert, a prisoner's dilemma tempts the European Union and the United States to each cut a separate preferential deal with third countries and regions-- and sometimes to explicitly agree to act against the interests of each other. The actions and reactions of the European Union and the United States in the recently-concluded auto talks with Japan attest to the problem. The game could begin to repeat itself in Asia next year: while the United States dances with Asia through APEC, the European Union is arranging its own set of meetings with ASEAN countries, China, Japan, and South Korea for early 1996. Other countries see that Europe and the United States can be divided, and play the trans-Atlantic partners off one another. Many in the United States perceive the recent Chinese auto agreement with Mercedes-Benz as the result of China playing the European Union off the United States and making its final decision based partly on non-commercial diplomatic considerations.

The flip side of the temptation to cut a preferential deal with a third country is the frustration of expending political resources unilaterally to resolve a trade problem on an MFN basis. The European Union and United States face many trade problems which if resolved on an MFN basis would have the qualities of a public good. When one trans-Atlantic power must act alone to resolve such a problem, and the resolution is on an MFN basis, the other power may simply free ride on the result. For example, the European Union refused U.S. requests for help in negotiating improved intellectual property protection in China; U.S. negotiators' unilateral action resulted in China agreeing to protect intellectual property on an MFN basis; and EU negotiators rushed to China to confirm that they would be able to free ride off the U.S. action. This process creates bilateral diplomatic resentment and is itself an incentive to instead fashion deals on a preferential basis. Thus, it is not surprising that some Europeans have accused the United States of concluding a preferential bilateral agreement with Korea on access for beef, and some Americans interpret the EU Commission's recent green paper on ways to improve commercial ties with China as an effort by the European Union to achieve preferential access and relationships there.

In multilateral negotiations, some of the same problems reappear. Facing intense domestic political pressure associated with outstanding bilateral trade problems, Europe and the United States often spend more time in multilateral negotiations-- and associated bilateral and plurilateral meetings-- bickering on topics that divide them than on managing the multilateral system and coordinating their positions on common problems. When they do attempt to coordinate, one side or the other often gets the sense that it will be (or has been) double-crossed. For example, U.S. negotiators have complained that EU negotiators broke their promise of support for intellectual property protection for pharmaceuticals in the pipeline in exchange for concessions from India. GATT/WTO institutional rules do not help the matter: consensus decision-making contributes to an environment in which ad hocery flourishes, since the consensus rule does nothing to encourage coordinated management of the system by those with power.

There are also serious substantive political obstacles to enhanced trans-Atlantic cooperation on trade issues. Differences over several issues-- agriculture; the Broadcast Directive; subsidies to steel, shipbuilding, and aerospace; intellectual property protection for appellations of origin; shipping and telecommunications services regulations; to name a few-- sour the atmosphere. Differences in the approach by which the European Union and the United States each deal with third countries (i.e., U.S. use of Section 301 versus Europe's less facially confrontational approach) hinder cooperation.

These problems discourage the efficient combination of European and American power that has proven crucial to managing the multilateral system.

#### **IV. New Mechanisms And Institutions To Organize Trans-Atlantic Cooperation: The Promise of a Trans-Atlantic Economic Area With Conditional MFN**

Before regional groupings further expand and deepen, potentially heading down divergent trajectories, and before other strains on the multilateral system further weaken European and U.S. political commitment to it, the European Union and the United States should establish mechanisms and institutions that change the way they address problems with each other, third countries, and the multilateral system.

A TEA could serve as a cornerstone of enhanced cooperation. A TEA offers through liberalization not only increased efficiency and consumer welfare, but also an end to tension-

producing trade and investment diversion associated with the powers' respective regional free trade arrangements, and a resolution of the outstanding EU-U.S. trade disputes that divert EU and U.S. attention from more serious strains on the multilateral system. Moreover, a TEA would entail the simultaneous negotiation of outstanding bilateral trade issues, transforming the trans-Atlantic dialogue from a series of issue-by-issue/single sector, zero-sum discussions to a single positive-sum cross-issue/cross-sector negotiation.<sup>6</sup> It might be possible to reach a political resolution of several problems even when those problems could not be resolved if addressed individually. And a TEA would permit governments to more easily appeal to broad trans-Atlantic political considerations and commitments in rejecting domestic pressure for trade-closing proposals and in efforts to further liberalize trade.

Independent of establishing other mechanisms or institutions to help address common problems with others, a TEA would help make it easier for the two powers to cooperate in efforts to liberalize trade with the rest of the world. By reaching trans-Atlantic agreement on a series of trade issues through a TEA, the two powers will have effectively harmonized their positions and interests on those issues for purposes of negotiations with countries outside the TEA. During implementation, bureaucrats and legislatures will be effectively "locked in" to the TEA's agreed rules and approaches. After complete implementation of a TEA, bureaucrats and industry in the European Union and the United States will have conformed to the TEA rules. There would be relatively few trans-Atlantic differences for other countries to exploit. The prisoners' dilemma will be partly solved.

Moreover, a TEA could be used to foster the multilateralization of more liberal rules in a relatively passive, non-aggressive manner by simply making the TEA open for accession (through negotiation) to any country willing to adopt all TEA obligations, an offer to effectively end the risk of trade diversion from the giant TEA market in exchange for transforming other national economic systems into conformity with the Western liberal model implicit in a TEA.

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<sup>6</sup> On any one trade issue, gains by producers on one side of the Atlantic often represent losses to producers on the other side, making resolution of that issue politically difficult. In contrast, a multi-issue trade negotiation (like the NAFTA negotiations or any trade round) can be shaped to yield a group of "winners" that is bigger than the group of "losers" on each side of the Atlantic. For example, the battle over complete agricultural liberalization alone is difficult to resolve because it would benefit most politically-important U.S. producers and hurt many European farmers, an outcome not acceptable to France. Similarly, the battle over liberalizing all shipping services alone is hard to resolve because it would benefit European shipping companies and hurt U.S. shippers enjoying a limited monopoly under the Jones Act, an outcome not acceptable to the U.S. Congress. In contrast, a TAFTA would liberalize "substantially all" trade, creating a set of "winners" and "losers" on both continents; if the "winners" were more powerful than the "losers" on both sides of the Atlantic, then all outstanding issues could be resolved.

Since a long-term goal should be the multilateralization of TEA-like rules, in negotiating the TEA, the European Union and the United States should take into account the position of countries outside the TEA area before finally agreeing how to resolve each issue.

Ultimately, a TEA could serve as a means of ratcheting regional liberalization towards multilateral liberalization through joining the world's two most important sets of "hub and spokes" trade regimes. It is possible to see U.S. regional negotiations help liberalize the Western Hemisphere; EU regional negotiations help liberalize Central and Eastern Europe, the Mediterranean, and perhaps Africa; and a TEA (conditionally open to third countries) eventually might be shaped to serve as a vehicle for merging the two sets of regimes.

But a TEA will not be easy to negotiate in the short-term. The biggest problem is agriculture. While it is far from clear that agriculture needs to be fully liberalized in a TEA to satisfy GATT requirements,<sup>7</sup> it is certain that agricultural issues create a trans-Atlantic political problem that is not easily solved: a deal without agriculture probably will not be acceptable to the U.S. Congress, and a deal with agriculture probably will not be acceptable in Brussels. This does not mean that negotiation of a TEA is hopeless. Continued U.S. and Cairns Group pressure on the subject will help, especially when agricultural negotiations in the WTO resume in five years. As Central European countries join the European Union-- especially Poland and Hungary-- the continued viability of the CAP will be questioned. And further long-term decline in the value of the dollar would put additional pressure on the CAP. Eventually, the agriculture problem will likely become more easily solved.

## **V. Other Trans-Atlantic Mechanisms And Institutions to Reduce Strains and Fractures in The World Trading System**

Other actions-- short of a conditionally open TEA-- could be taken by the European Union and the United States to help reduce strains and fractures in the world trading system. Some of these efforts are already underway. Many of these mechanisms could be retained as part of a TEA, if one is created.

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<sup>7</sup> GATT Article XXIV. 8(b) requires that, in creating a free-trade area, trade barriers be eliminated on "substantially all" the trade between the constituent territories. But "substantially all" is not defined and never has been. Moreover, the GATT Contracting Parties consistently approved European Free Trade Area agreements with third countries that expressly exclude all agricultural products from liberalization.

First, the current trans-Atlantic attempt to establish stand-alone bilateral agreements on topics that offer mutual benefit is a step in the right direction. For example, the nascent effort to reach agreement on mutual recognition of product certification and testing is likely to be successful and beneficial to both the European Union and the United States. The parties should also continue to negotiate "rules of the road" on relatively technical issues, such as on-going sectoral efforts to harmonize certain technical standards and on-going consultations on customs matters. Agreements on these topics should be relatively easy to negotiate (compared to topics like agriculture or the EC Broadcast Directive), will reduce some bilateral trade friction, and are subjects that would form part of a TEA.

Second, the European Union and the United States should establish a process and consider "rules of the road" governing their regional arrangements with third countries. The parties should more seriously discipline preferential (i.e., regional) rules of origin, which are intentionally used to exacerbate trade diversion effects of free trade areas (FTAs) and customs unions. They should consider a "standstill" commitment against the adoption of new preferential rules of origin that differ substantially from non-preferential rules; and they should consider a promise to compensate each other if they violate the standstill agreement. Eventually, preferential rules of origin should be harmonized if the EU- and U.S.- centered regimes are to be fully joined. The parties should also consider rules ensuring that certain elements of their respective regional arrangements not presently covered by the WTO (e.g., rules on investment) will be applied to each other on an MFN basis. More broadly, as the EU- and U.S.-centered regional arrangements expand or add associated states, they should take into account the interests, economic structures, and rules of each other's national and regional economic systems. In APEC and FTAA negotiations, the United States should consider effects on Europe and a potential TAFTA; in EU expansion and association negotiations, Brussels should consider effects on the United States and a potential TAFTA. In order to do so effectively, the parties might undertake a review of their respective FTAs and customs unions, with a view towards harmonizing their substantive rules as far as possible in preparation for eventually joining the U.S.-centered and EU-centered systems through a TAFTA (or through multilateral action).

Third, the parties should negotiate agreements on important topics not yet covered by the WTO and use those agreements as a basis for further liberalizing world trade and investment. Most of these agreements should offer MFN and national treatment to others only on the

condition that they negotiate accession, agreeing to undertake its obligations and schedule appropriate concessions. For example, Europe and the United States should intensively negotiate their version of an agreement on investment so as to coordinate a position that they could take in the OECD MAI negotiations and in later WTO negotiations on the subject; the agreement would promise MFN and national treatment on investments only to signatories, thereby creating an incentive for other countries to negotiate accession. Similarly, a trans-Atlantic agreement on competition policy would not only resolve relatively minor EU-U.S. differences on the topic, it would also coordinate a position that the European Union and the United States could use as a basis for negotiation with third countries and serve as a basis for action against anti-competitive behavior throughout the world. Such an agreement might embody provisions establishing rules on the extraterritorial application of competition policy, define as impermissible specific types of anti-competitive behavior faced by both EU and U.S. exporters, establish obligations on the extra-jurisdictional production of evidence, and establish certain presumptions where evidence is not produced or otherwise difficult to obtain.<sup>8</sup>

Fourth, the European Union and the United States should reorganize cooperation and coordination on common problems with third countries. This has two elements: (1) identification of topics and countries on which to cooperate, and (2) an effective mode for coordinated action. Initial topics might include access to Japan's automobile and electronics industries, competition policy issues in certain countries, and the role of the state in the transitional economies. For the longer term, the powers should decide on a process for identifying topics.

The hard part will be agreement on an appropriate mode for coordination, given U.S. attachment to Section 301 and Europe's disdain for it. One possibility is U.S. agreement to refrain from using Section 301 during a period when the European Union and the United States are effectively coordinating action on a particular topic and country. The USTR could be required to certify every 120 days that such coordination is producing positive results; failure to so certify would then require the USTR to treat (or consider treating) the problem under Section 301. Both the European Union and country that is the focus of the liberalization effort would have incentives to make the negotiations work, since they both dislike the Section 301 approach.<sup>9</sup>

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<sup>8</sup> The U.S. Government would likely have to agree to modify its anti-dumping laws in exchange for a meaningful agreement on competition policy.

<sup>9</sup> The European Union and the United States should also attempt to define circumstances in which they would be willing to jointly pursue more aggressive market-opening tactics, perhaps employing elements of the Section 301 or

Where the parties can not agree how to jointly solve a common problem in a third country, they should have "rules of the road" to ensure that they do not undercut each others' initiatives there. These rules might include: a commitment to conclude agreements on an MFN basis; a promise not to publicly attack specified approaches that may be used by a trans-Atlantic power in negotiations; and a commitment to continuously consult with each other on the process and progress of negotiations.

Fifth, Europe and the United States should reorganize their cooperation in managing the WTO system. Initially, the powers should determine the topics on which they could cooperate, such as: China's accession; competition policy rules; and unfinished business from the Uruguay Round in telecommunications services and accelerated application of TRIPs to developing countries. They also need to determine the appropriate mode of coordination. The European Union and the United States could agree to engage in regular monthly meetings for the exclusive purpose of identifying topics for cooperation and planning a coordinated approach. The European Union and the United States should discuss the possibility of defining topics on which they would agree to support only those WTO proposals that neither party objects to; this would help ensure that the two powers coordinate their positions and do not undermine joint management of the organization. In the longer term, the European Union and the United States should consider alternatives to the WTO consensus decision-making rule: creation of an executive committee could provide a useful forum for regularized management; a U.N. Security Council-style voting system-- majority rule, with specified members having a veto-- could speed up the decision-making process and formalize efficient governance of the WTO system. These approaches recognize that the multilateral system has been managed effectively only through close trans-Atlantic cooperation and coordination.

### **Conclusions: A Conditionally Open Trans-Atlantic Economic Area, Other Approaches To Reducing Strains On The World System, And The Rest Of U.S. Trade Strategy**

Global political-economic trends suggest the importance of reorganizing the way the European Union and the United States cooperate on trade. Movement towards deeper trans-Atlantic integration is only a partial solution because it would address only bilateral trade issues.

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the EU Common Commercial Policy approaches. However, the prospects for reaching trans-Atlantic agreement on this point are slim.

It would be a mistake not to structure such deep integration so its results could be multilateralized, and not to simultaneously work towards reorganizing trans-Atlantic cooperation to address common problems with third countries and management of the multilateral system. At best, failure to do so would represent a lost opportunity for mutual gain by both Europe and the United States. At worst, it could damage a deep integration endeavor: EU-U.S. trade relations would likely be strained by continuing competition for preferential advantage in negotiations with third countries and by finger-pointing over the slow pace of success in the WTO. More broadly, failure to simultaneously work towards multilateralizing trans-Atlantic arrangements could move the world towards a dangerously regionalized and possibly bipolar trading system. And failure by the European Union to help the United States speed up the process of multilateral liberalization will leave U.S. trade policy with little choice other than to resort to a unilateral and regional strategy. The trans-Atlantic powers should deepen integration between them, offering MFN and national treatment to third countries conditioned on their willingness to undertake the deep integration obligations, and pursue other mechanisms (elaborated above) that will reduce strains and fractures in the world trading system.

This will not be easy. Deeper trans-Atlantic integration will require careful assessment of how to structure a deal that will create successful political coalitions in both Europe and the United States. In the short-term, negotiation of a TEA (or even a TAFTA) will be very difficult: for example, the European Union will resist placing agriculture and the Broadcast Directive on the table; the United States will resist placing shipping services and Section 301 on the table. Moreover, many European governments, seeing that they have already deepened integration with many of their important trading partners through the EU, may be less convinced than those in the United States about the need to find new approaches to enhancing and accelerating multilateral liberalization.

As the process of reorganizing trans-Atlantic cooperation moves forward, the United States should not divert its attention from other elements of its trade strategy. Until improved trans-Atlantic trade cooperation is in place and successful, the United States must continue to pursue its interests unilaterally and build its own regional systems in the Americas and Asia-Pacific. Those efforts have intrinsic merits, liberalizing markets close to home and contributing to the development of democracy. They will provide insurance in case the experiment in trans-Atlantic trade cooperation does not fully succeed. And they will enhance the U.S. negotiating

position with Europe by proving that the United States has alternative options, creating a larger economic market with which to entice European negotiators, and positioning the United States to legitimately claim that it is locked into approaches reflected in various regime rules that it will have negotiated with many other countries.