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TRADE WITH THE EUROPEAN UNION

Recent Trends and Electronic Commerce Issues

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G A O

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Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to provide this statement for the record for your hearing on October 13, 1999, on U.S. trade with the European Union (EU). As major trading partners, the United States and the EU are currently addressing several trade-related issues, including their approach to electronic commerce, or e-commerce.

My statement will focus specifically on (1) the size and composition of U.S.-EU trade and investment flows from 1992 through 1998 and (2) U.S.-EU efforts to facilitate e-commerce. My observations are based on GAO's past and ongoing work,¹ our analysis of trade and investment data, our review of executive branch and other documents, and our discussions with U.S. government and private sector officials.

Summary

The sizeable and growing U.S.-EU trade relationship is dominated by flows of sophisticated manufactured goods and services and extensive cross-Atlantic investment. E-commerce has tremendous potential for facilitating U.S.-EU trade, but it also raises numerous issues, including consumer protection and market access. The United States and the EU are attempting to lower these potential barriers to e-commerce through the framework of the World Trade Organization (WTO) and other forums.

U.S.-EU Trade and Investment Relationship Is Large and Growing

The European Union and the United States have the world's largest trade and investment relationship. In 1998, the EU was the leading U.S. trading partner, the largest recipient of U.S. direct investment abroad, and the biggest foreign direct investor in the United States. The EU has retained its dominant share of U.S. trade over the past decade even as U.S. trade with the rest of the world has grown. In 1998, 1 out of every 4 dollars in U.S. exports was destined for the EU market, and 1 out of every 5 dollars in U.S. imports was spent on EU products.

The EU is the largest foreign direct investor in the United States as well as the largest recipient of U.S. direct investment. On a historical-cost basis,

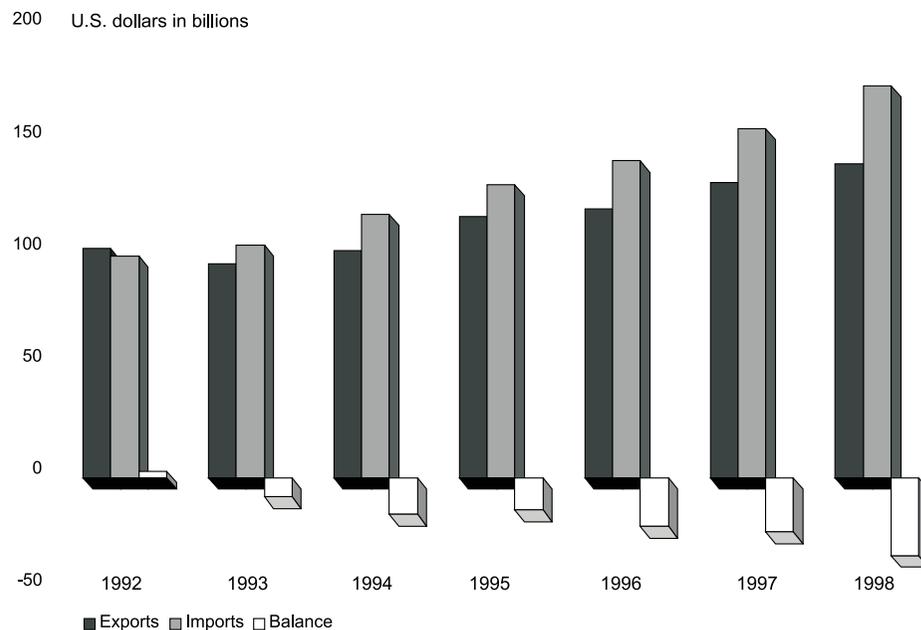
¹At the request of the House Ways and Means Subcommittee on Trade, GAO is currently examining the issues to be considered in Seattle, Washington, at the November 1999 World Trade Organization Ministerial Conference meeting.

the EU had \$481 billion invested in the United States in 1998 and the United States had \$434 billion invested in the EU. These figures represent about 59 percent of all foreign direct investment in the United States and 47 percent of all U.S. direct investment abroad. For both the EU and the United States, manufacturing industries, such as chemicals and autos, and services industries, such as banking and insurance, are the leading sectors for such investment.

Bilateral Trade Deficit Widening

Over the past 6 years, the U.S. merchandise trade account has gone from a surplus of \$3 billion in 1992 to a deficit of \$34.7 billion in 1998, as U.S. growth rates exceeded those in Europe and the U.S. dollar remained strong against European currencies. (See fig. 1 for an illustration of U.S.-EU trade from 1992 to 1998.)

Figure 1: U.S.-EU Merchandise Trade, 1992-98



Source: U.S. Department of Commerce.

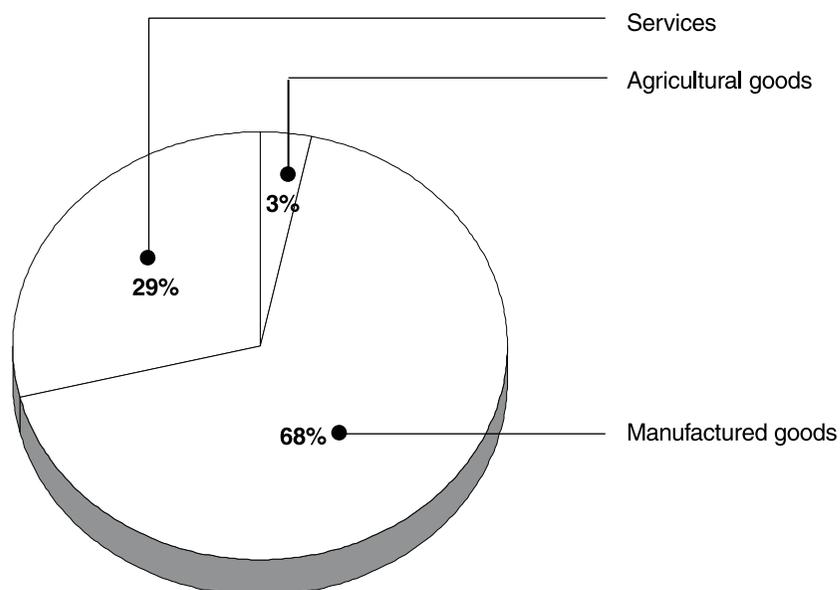
The United States is urging the EU to make structural changes in its tax, employment, and other policies to bolster its economic growth and imports. Recent economic indicators for the EU show positive expansion

and the International Monetary Fund's recent World Economic Outlook report predicts such growth in the EU and elsewhere will spur demand for U.S. exports.

U.S.-EU Trade Largely Comprised of Industrial Products and Services

Over two-thirds (68 percent) of the approximately \$440 billion in total U.S.-EU trade in 1998 was comprised of manufactured goods. Services, such as financial and business services, constituted about 30 percent of bilateral trade. Agriculture—often a sticking point in U.S.-EU trade relations—accounted for just 3 percent of U.S.-EU trade. However, the EU is the second leading destination for U.S. exports of agricultural products and second leading supplier of U.S. agricultural imports. (Fig. 2 illustrates the share of U.S.-EU trade that each sector represented in 1998.)

Figure 2: Share of Total U.S.-EU Trade, 1998

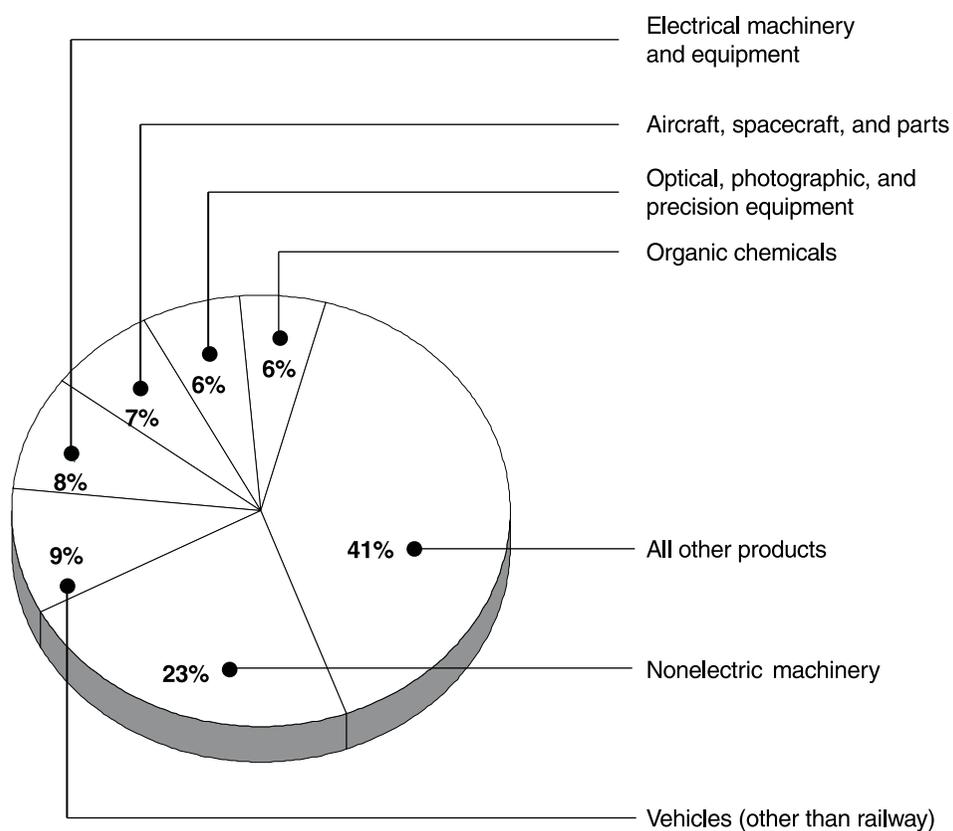


Source: U.S. Department of Commerce.

The United States and the EU are strong competitors and leading buyers in major product sectors. For example, electric machinery and precision instruments are among the top categories in U.S. exports to and imports from the EU. In 1998, U.S. exports of electric machinery to the EU amounted to \$15 billion, an increase of nearly 60 percent from 1992 levels.

Other leading categories include nonelectric machinery, aircraft and other transportation equipment, chemicals, pharmaceuticals, processed foods and beverages, and steel. (Fig. 3 shows the share of total U.S.-EU merchandise trade by product group for 1998.)

Figure 3: Share of Total U.S.-EU Trade by Product Group, 1998



Note: Percents do not add up to 100 percent because of rounding.

Source: U.S. Department of Commerce.

U.S.-EU Efforts to Facilitate E-Commerce

The United States and the EU both recognize the potential of e-commerce to expand trade and spur growth. Therefore, both partners have collaborated on efforts to maintain an open international environment and to liberalize related industries. However, e-commerce and the Internet are characterized by decentralized, “borderless” interactions that affect the way businesses and consumers operate. These qualities have given rise to a variety of new policy questions, such as consumer protection and market access. Although the United States and the EU agree on key policy goals, they have taken different approaches to these challenges, resulting in current or potential trade disputes. U.S.-EU differences over e-commerce are currently being addressed in the context of the World Trade Organization, the Organization for Economic Cooperation and Development,² and through bilateral means.

The Importance of E-Commerce

E-commerce, as defined by a recent WTO Secretariat special study,³ includes the production, advertising, sale, or distribution of products via telecommunications networks. For example, consumers may order clothing through the Internet and have it physically delivered, or order music from a website and have it electronically delivered to their personal computer. A doctor may provide a traditionally face-to-face service through a video-link and have payment handled completely electronically through a transfer of funds. All of these involve e-commerce to some degree.

U.S. and EU leaders recognize e-commerce as a valuable business tool and an important engine of economic growth. Although still relatively small, e-commerce is a rapidly growing part of the world economy. The United States Trade Representative (USTR) reports that by 2005, an estimated 1 billion people will be using the Internet and e-commerce transactions in the United States alone may reach \$1.3 trillion by 2003. In addition to opening doors for new products, services, and modes of distribution, beneficial indirect effects can be gained from e-commerce such as reduced

²The Organization for Economic Cooperation and Development (OECD), created in 1960, is a forum for monitoring economic trends and coordinating economic policy among 29 countries, including the United States and the 15 members of the EU. The OECD has adopted principles on some aspects of e-commerce. The OECD is also conducting analytic work regarding e-commerce. This work addresses consumer protection and other issues.

³World Trade Organization, *Electronic Commerce and the Role of the WTO* (Geneva, Switzerland: World Trade Organization, March 1998).

transaction costs, more efficient production processes, and expanded production of information technology products.

The United States and the EU are leaders in exploiting e-commerce's potential. The United States generated over 85 percent of worldwide Internet revenue in 1996-97, according to the WTO. Europeans generated about 5 percent of Internet revenue, but this is expected to double by 2001. The United States has the largest number of Internet users and websites in the world, but Europe has been called one of the fastest growing Internet markets. According to the Department of Commerce, most of the available data on the growth of e-commerce comes primarily from industry sources. Using this data, forecasters have predicted significant growth in e-commerce worldwide. In early 1998, online retail sales were projected to reach \$7 billion by the year 2000. The Department of Commerce reports that the \$7 billion mark was already surpassed by year-end 1998.

U.S.-EU Initiatives to Expand E-Commerce

The United States and the EU have worked cooperatively to maintain an open international environment for e-commerce and to liberalize related industries. They have also agreed on other key policy goals.

World Trade Organization Initiatives

Within the World Trade Organization,⁴ the United States and the EU have taken the lead in concluding

- the 1996 Information Technology Agreement, which reduces tariffs to zero on information technology products such as computers and semiconductors by 2000 for most countries;
- the 1997 WTO Basic Telecommunications Agreement, which liberalizes the telecommunications services market—the infrastructure of the Internet and e-commerce; and
- a 1998 Ministerial Declaration on Global Electronic Commerce calling for a (nonpermanent) moratorium among WTO members on the collection of customs duties on e-commerce transmissions and the launch of a WTO work program to examine issues related to e-commerce.

⁴The WTO administers rules for international trade and provides a forum for resolving trade disputes and conducting trade negotiations. Established by the Uruguay Round Agreement in 1994, the WTO provides the institutional framework for the multilateral trading system.

The Information Technology Agreement effectively resolved a U.S. dispute settlement case of potential relevance to e-commerce. The United States brought the case in the WTO against the EU's tariff classification of computer equipment. Two EU member states had decided to classify computers with networking capabilities as telecommunications equipment and classify a type of personal computer with multimedia capabilities as televisions for tariff purposes, thus subjecting such computers to a tariff rate that was nearly double that previously applied. The EU later did a similar thing for local-area network equipment. The United States initiated WTO dispute settlement procedures against the EU and its two member states in 1996. However, as a result of the Information Technology Agreement, the EU agreed to reduce the tariffs in question to zero by January 2000. The EU also confirmed that in the future it would treat multimedia personal computers as computers for tariff classification purposes. The EU's action restored the tariff treatment of such computers to that desired by the United States.

WTO members will be addressing several initiatives related to e-commerce at its Ministerial Conference meeting this November in Seattle. Efforts are underway to sign a new agreement on information technology. This agreement would further reduce tariffs, cover additional products, and address non-tariff barriers.

WTO members must also decide in Seattle whether or not to extend their current moratorium on imposing duties on electronic transmissions. The United States originally proposed that the Seattle Ministerial result in a permanent moratorium, but the EU, Japan, and Australia have only given support for a nonpermanent moratorium until the WTO's examination of e-commerce issues is completed. The current and proposed moratorium only covers electronic transmissions and not products physically imported after being ordered electronically. No WTO members impose such duties, and the moratorium is an effort to maintain that practice. The moratorium does not cover domestic taxation.

Bilateral Initiatives

Within the context of the 1995 "New Transatlantic Agenda," a framework to enhance cooperation and promote joint action on trade and other matters, the United States and the EU have specifically pledged to facilitate electronic commerce and signed a Joint EU-U.S. Statement on Electronic Commerce. The statement includes a commitment by each government to provide a clear, consistent, and predictable legal framework to promote competition. This statement also reflects agreement by the United States and the EU on several key policy goals related to e-commerce, including

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- ensuring a liberal environment for international transactions;
 - protecting personal information, privacy, and intellectual properties;
 - developing legal and institutional structures to support electronic business; and
 - providing universal access domestically and internationally.

U.S. and EU government officials have the benefit of receiving regular business input into their discussions on e-commerce from the Transatlantic Business Dialogue, a forum of high-level U.S. and EU business leaders. The Transatlantic Business Dialogue's May 1999 midyear report offered several recommendations on electronic commerce, including instituting strong intellectual property rights protection for information transmitted over the Internet and harmonizing and simplifying export regulations for products containing cryptographic capabilities.

Current and Potential Areas of U.S.-EU Disagreement on E-Commerce Issues

Despite agreement on the overall promotion of e-commerce, U.S. and EU approaches to various legal and policy issues have differed. This has manifested itself in discussions over the coverage of e-commerce under WTO rules and on data protection. U.S.-EU positions on other subjects—Internet “domain” names, encryption, and digital signatures—have been the subject of bilateral differences but have not reached the point of dispute. The United States and the EU are engaged in efforts to bridge their remaining differences bilaterally and in the WTO.

Coverage of E-commerce Under Global Trade Rules

WTO members have been examining the coverage of e-commerce under existing WTO agreements as part of the WTO's e-commerce work program. The work program involves reviews by four existing WTO bodies of how multilateral trade agreements apply to global electronic commerce.⁵ In that context, the United States and the EU have disagreed on whether or when e-commerce should be classified as a “good” or a “service” under global trading rules. The EU has proposed to the WTO that e-commerce transactions, including any content transferred, be considered services, and suggested that a decision to that effect should be reached soon. The United States believes that it is premature to reach a definitive conclusion on the classification of e-commerce, given its evolving nature and WTO members' limited understanding of how such a decision could affect market access and other trade rights. As a general rule, however, the

⁵The four WTO bodies are the Committee on Trade and Development, the Council on Trade-Related Intellectual Property, the Council on Goods, and the Council on Services.

United States has proposed that e-commerce should receive the most liberal treatment available, whether as a good or a service.

The U.S.-EU disagreement stems from the fact that electronic commerce consists of two types of deliveries. The first involves items ordered electronically but delivered physically, such as software received through the mail on a computer disk. The second involves items both ordered and delivered electronically, such as software transmitted directly to one's computer. The EU considers both ordering and receiving items over the Internet to be the delivery of a service. The United States, on the other hand, maintains that such transactions can involve either a good or a service, depending upon the circumstances. How e-commerce is classified has trade implications because, in some cases, WTO rules provide relatively greater certainty of market access and equal treatment to goods than to services.

These and other issues will be addressed in a report to the WTO's November 1999 Ministerial Conference meeting in Seattle. A decision on the future of the WTO's e-commerce work program is to be made at that time.

Data Protection

The protection of personal data is another notable area of contention. The United States has supported industry self-regulation as the primary means of protecting personal information. The European Union instead has opted for a comprehensive regulatory approach. In October 1998, the EU enacted the so-called Data Protection Directive, which only permits the transfer of personal information from Europe to third countries that provide "adequate" data protection.

Following this directive, U.S. officials began a dialogue with the EU comparing the protection of the U.S. system with that mandated in the EU. In those areas where differences in the level of protection existed, the Department of Commerce proposed to bridge them with an agreement with the EU on a set of "safe harbor" principles for U.S. companies to follow. U.S. firms that subscribed to the safe harbor principles would be presumed to provide adequate privacy protections. Data transfers from the EU to them would continue. Among other things, these principles will likely prescribe a level of security for data transmissions and specify recourse mechanisms for complaints about the use of data.

The EU's Data Protection Directive is already in effect, but the EU has pledged to avoid disrupting data flows to the United States so long as

negotiations continue in good faith. The United States and the EU are working to complete an agreement by the next U.S.-EU summit in December. However, considerable differences remain over enforcement of the principles by industry associations and the length of time U.S. firms would have to implement the principles. The EU has accepted the U.S. approach of industry self-regulation, but wants assurance that U.S. industry self-regulating groups will be independent from the companies they are regulating and able to enforce compliance with the principles. Also, U.S. firms want to have a longer period of time to implement the principles than the EU is currently willing to accept. According to the Department of Commerce, multinational corporations with operations in Europe and the United States, financial organizations, and other companies with significant transatlantic business could be harmed if agreement is not reached.

Internet “Domain Names”

In addition to these current disputes, the United States and the EU have grappled with differences over what process would be entrusted to register new website names and addresses, also known as “domain names” on the Internet. Domain names, such as “www.senate.gov” or “www.ibm.com,” are used to identify the millions of websites worldwide for individuals “surfing” or navigating the Internet. As such, they have also developed into business identifiers because they are easy to remember and use.

As the Internet has become more global, the EU and others have raised questions about how these names are assigned. Historically, the task of registering domain names was overseen by the U.S. government and contracted to public and private entities. As part of the executive branch’s 1997 Framework for Global Electronic Commerce, the Department of Commerce has begun a process of privatizing management of the Internet name and address system to increase competition and facilitate global participation while preserving the stability of the internet. Commerce’s initial recommendation in February 1998 was met with criticism by the EU, which claimed that the proposal seemed to seek exclusive U.S. jurisdiction over the Internet. However, Commerce issued a second draft in June 1998, which led to the formation of the Internet Corporation for Assigned Names and Numbers—a nonprofit corporation assigned to oversee the transition to private management. The EU has stated that it supports this approach. However, the privatization process has just begun, and, given its importance and complexity, the potential exists for more disputes regarding domain names.

Encryption and Digital Signatures

The security and verification of information transferred digitally is a basic requirement for the growth of e-commerce. Encryption technology, of

which the United States is a leading producer, is necessary for the transfer of sensitive information across public networks. However, the availability and export of sophisticated encryption software raise important national security and law enforcement concerns. For instance, should legal authorities have access to the “key” to decrypt electronic transmissions to monitor illegal activities? Also, how can export controls protect national security while still fostering domestic innovation? The United States restricts exports of encryption systems, but recently the executive branch has proposed changes that would significantly loosen such restrictions. The United States and the EU are also working to simplify their respective review processes for exporting encryption products.

In addition to requiring the security of information, business transactions typically rely on legal contracts, which in turn require signatures. The expansion of e-commerce depends upon the existence of a legal framework for acceptance of electronic signatures, as well as the technology to authenticate or verify those signatures. Both the EU and the United States have been developing just such a framework. However, differences in the types of technology required or in the legal definitions between the United States and the European Union may limit certain transactions or hinder innovation. Noting the global nature of the Internet, the Transatlantic Business Dialogue has recommended that national governments coordinate their activities to avoid passing conflicting legislation and creating biases in favor of particular technologies.

Mr. Chairman, this concludes my statement for the record. Thank you for permitting me to provide you with this information. If you or your staff have any questions about this statement, we will be pleased to answer them.

Contact and Acknowledgment

For future contacts regarding this testimony, please contact Susan S. Westin or Elizabeth Sirois on (202) 512-4128. Individuals making key contributions to this testimony include Kim Frankena, Nina Pfeiffer, and Tim Wedding.

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