United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on International Trade, Committee on Finance, U.S. Senate

February 1990

EUROPEAN SINGLE MARKET

Issues of Concern to U.S. Exporters

GAO/NSIAD-90-60

GAO
United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-237894

February 13, 1990

The Honorable Max Baucus
Chairman, Subcommittee on
International Trade
Committee on Finance
United States Senate

Dear Mr. Chairman:

This report responds to your August 9, 1989, request that we identify and evaluate issues related to the European Community's Single Internal Market Program, known as EC 1992, of concern to U.S. exporters. We focused on the issues of product standards, testing, and certification; rules of origin; and public procurement requirements.

Copies of this report are being sent to the Secretaries of Commerce and State, the United States Trade Representative, and to other interested parties. This report was prepared under the direction of Allan I. Mendelowitz, Director, International Trade and Finance Issues. He can be reached on (202) 275-4812, if you or your staff have any questions. Other major contributors are listed in Appendix I.

Sincerely yours,

Frank C. Conahan
Assistant Comptroller General

Executive Summary

Purpose

In 1989, many congressional committees held hearings on issues related to the European Community (EC) Single Market program, commonly known as EC 1992. Of particular concern is the impact of EC 1992 on small and medium-sized U.S. exporters that do not have European subsidiaries.

At the request of the Chairman of the Subcommittee on International Trade, Senate Committee on Finance, GAO identified issues related to the EC 1992 program that will affect market access for U.S. exporters and evaluated those issues GAO believed to be of the most concern.

Background

In 1985, the EC approved the Single Internal Market program, comprising almost 300 measures, with the goal of removing barriers to the free movement of goods, services, capital, and people among its 12 member states by the end of 1992.

In June 1989, the EC reported that the process of completing the internal market was irreversible. At the end of 1989, about 93 percent of the legislation needed for the program had been proposed, and 51 percent had been adopted.

The EC comprises a market of over 320 million people and is the largest U.S. trading partner. The Departments of Commerce and State, and the Office of the United States Trade Representative (USTR) all play roles in monitoring and providing information to interested parties on EC 1992 and in trying to influence the EC 1992 process.

Results in Brief

The EC 1992 program could provide substantial benefits to U.S. exporters; however, some unresolved market access questions are cause for U.S. concern and are being watched by the federal government. Some proposed restrictive practices could limit increased U.S. access in the areas of (1) product standards, testing, and certification, (2) rules of origin, and (3) public procurement.

- U.S. exporters generally must meet national standards and have their products tested and certified in each EC country where sold. Under EC 1992, a U.S. exporter legally will have to meet only one standard and have its product tested in one EC country to sell throughout the EC. However, U.S. exporters were concerned whether EC countries will be able to use the European standards-setting, testing, and certification processes to keep products out.

- The way the EC recently has applied its rules of origin to various electronic and high technology products and components has raised U.S. industry's concern that the EC will use these requirements to promote or to protect certain industrial sectors. U.S. business and government officials fear this action could force U.S. companies to build plants and other facilities in Europe to avoid such barriers.
- The EC is seeking to open its public procurement market in sectors previously closed to non-EC suppliers, ostensibly giving U.S. exporters more sales opportunities. However, because proposed bid requirements applicable to these sectors may be applied in a discriminatory manner, U.S. exporters face a great deal of uncertainty.

EC standards, testing, certification, and public procurement requirements will probably not be any more restrictive than they are today and may provide greater opportunities for U.S. exporters. However, the EC seems to be increasing the number of products to which rules of origin, particularly value-added origin rules, are to be applied.

GAO's Analysis

Standards, Testing, and Certification

A key issue is whether it will be easier for U.S. exporters to meet European standards and to get their products tested and certified for sale in Europe under EC 1992. Currently, U.S. exporters sometimes must make costly modifications to their products to meet different specifications in various EC member states. Frequently, a product certified for sale in one EC country does not meet the certification requirements for sale in another.

U.S. industry has expressed concern about access to the EC's standards-setting process and whether the process will enable individual EC member states to keep products out. On the whole, GAO believes that U.S. exporters will not be any worse off, and could be better off, under the new system.

A major concern of U.S. exporters is the need for more accurate and timely information about EC 1992. GAO learned that there are some ways to alleviate U.S. exporters' concerns. For example,

- the American National Standards Institute receives the work plans and draft standards of the European standards-setting organizations and

can, in turn, submit comments and concerns to those organizations on behalf of U.S. business.

- EC Directive 83/189 established an information procedure that permits examination of drafts of member state national standards to determine their compatibility with the principle of free circulation of goods. The U.S. government could seek access to this data for the benefit of U.S. exporters.

Rules of Origin

Recent EC initiatives involving rules of origin, particularly value-added origin rules, have sparked U.S. industry fears that the EC will use these requirements to promote or to protect certain industrial sectors. U.S. exporters in the electronics industry and in the auto parts industry are concerned that manufacturers will replace U.S.-origin components with EC-origin components to avoid EC penalties. According to U.S. government officials, such concerns could lead U.S. companies to make costly capital investments in the EC when they are not necessarily ready to do so from a business or marketing perspective.

To counteract these concerns, U.S. officials are negotiating an agreement on an internationally accepted definition of rules of origin during the current round of multilateral trade negotiations.

Public Procurement

The $630-billion EC public procurement market has been largely untapped by U.S. exporters. Certain sectors, such as public construction and public utility projects, have not been covered by multilateral agreements and may still not be completely open to non-EC firms under EC 1992.

Under the EC's proposed plan, bid requirements for newly opened sectors will be different from those for sectors covered by multilateral agreements. Entities procuring in the former category would be permitted to exclude from consideration offers with less than 50-percent EC content. If they do consider such bids, they must grant a 3-percent price preference to equivalent offers having at least 50-percent EC content. This type of discrimination is not permitted for sectors covered by multilateral agreements.

U.S. officials are engaged in negotiations to extend a multilateral trade agreement to cover all public procurement sectors. Successful negotiations could increase U.S. export opportunities in EC public procurement.

Recommendations

This report contains no recommendations.

Agency Comments

As requested, we did not obtain written agency comments on this report; however, we did discuss its contents with officials from Commerce, State, USTR, and some private sector representatives and incorporated their comments where appropriate.

Contents

Abbreviations

ANSI	American National Standards Institute
CEN	European Committee for Standardization
CENELEC	European Committee for Electrotechnical Standardization
EC	European Community
ETSI	European Telecommunications Standards Institute
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade
IEC	International Electrotechnical Commission
ISO	International Standards Organization
ITC	International Trade Commission
NIST	National Institute of Standards and Technology
UL	Underwriters Laboratories, Inc.
USTR	Office of the United States Trade Representative

Introduction

The European Community (EC) is the largest U.S. trading partner, and trade-related events there have a major impact on U.S. business. In 1985, the EC approved a program to remove all physical, technical, and fiscal barriers to internal trade by 1992. This program, known as EC 1992, will affect all goods traded in or with the EC. As a member of the international trading community, the EC must continue to meet its multilateral trade obligations as it moves toward EC 1992.

The European Community and EC 1992

The EC is a market of over 320 million people, with a combined gross domestic product nearly comparable to that of the United States. When it was created by the Treaty of Rome in 1957, the EC consisted of Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany. Today it has 12 member states—the United Kingdom, Ireland, and Denmark joined the original signatories in 1973, Greece joined in 1981, and Spain and Portugal joined in 1986.

The EC accounted for over $155 billion in two-way merchandise trade with the United States in 1988. The United States sent some 23 percent of its exports to the EC in 1988, with the leading U.S. exports (29 percent) consisting of office machine parts, computers, aircraft and aircraft parts, engine parts, soybeans, and coal.

The Treaty of Rome envisaged a single, integrated European market. The first major focus of the Treaty was to remove all tariffs and quotas among the EC member states and to introduce a common customs tariff. The common customs tariff was completed in 1968, but integration languished for a number of years.

In the early 1980s, interest in EC integration revived because EC business perceived that the EC was less competitive with the United States, Japan, and the newly industrialized countries due to the fragmentation of the EC market. In 1985, the EC approved the 1992 program with the goal of removing all barriers to the free movement of goods, services, capital, and people among the 12 EC member states by the end of 1992. A White Paper, entitled "Completing the Internal Market," prepared by the EC Commission, the executive arm of the EC, listed almost 300 measures needed to achieve the single internal market. These measures are divided into the three following parts:

1. Elimination of physical barriers to reduce transport costs and result in significant time savings. Eliminating or reducing customs procedures

between EC member states should enable products to move as freely within the EC as they do in the United States.

2. Elimination of technical barriers to open previously closed national markets in areas such as insurance and public procurement. The single industrial standards for products with health, safety, or environmental implications should make it easier to market products throughout the EC.

3. Elimination of fiscal barriers to facilitate intra-EC trade. Different indirect tax rates among member states, such as differing value-added and excise taxes, necessitate border controls to avoid tax evasion. Harmonization of these indirect tax rates is one aspect of eliminating fiscal barriers. EC officials have said that fiscal barriers will be the most difficult barriers to eliminate.

Other anticipated benefits for Europe from this program include economies of scale in production for a larger market, increased competition in some sectors, greater research and development expenditures, lower prices, a greater variety of products to stimulate consumer demand, and lower budgetary expenditures on government regulations.

The EC's use of unanimous voting was a major impediment to earlier progress in integration because any single EC member state could veto proposed actions. To solve this problem, the EC passed the Single European Act, which allowed for qualified majority voting on almost all aspects of the single market. The act took effect on July 1, 1987, and represented a crucial step needed to move to the internal market.

In its June 1989 progress report, the EC Commission reported that the EC 1992 process is now irreversible but expressed concern that the progress toward removing most technical barriers could not hide the fact that nothing had been done to abolish physical and tax barriers. By the end of 1989, about 93 percent of the needed legislative measures had been proposed, and 51 percent had been adopted. The EC had adopted 142 of the 261 measures proposed; however, the percentage of adopted measures in force varied among the 12 member states.

EC 1992 and the General Agreement on Tariffs and Trade

Since its creation in 1948, the General Agreement on Tariffs and Trade (GATT) has been the forum for discipline in international trade. The GATT is both a system of principles specifying the rights and obligations of its contracting parties and an institution. The principles are based on the proposition that trade should be determined by economic factors rather than government intervention.

The basic principles that underlie GATT are (1) the most-favored-nation concept, which states that the contracting parties will conduct their commercial relations with each other on the basis of nondiscrimination, (2) national treatment, which provides that imported products should receive the same treatment as domestically produced products with respect to internal taxation and regulation, and (3) the concept that any protection of domestic industries should cause the least distortion to trade possible, and the belief that tariffs are the preferred form of protection.

The impact of EC 1992 on the GATT and the current round of negotiations scheduled to end in 1990 is not yet clear. According to the Office of the U.S. Trade Representative (USTR), EC 1992 initiatives frequently influence the position of EC negotiators in GATT talks. For example, the EC is attempting to liberalize and open its public procurement market in sectors not previously covered by the GATT Agreement on Government Procurement. With EC 1992, the EC has agreed to discuss extending coverage to include these sectors. Also, in negotiations on the effectiveness of the GATT Standards Code, a USTR official testified that the EC's internal approach to standards, testing, and certification has enabled its GATT negotiators to be more forthcoming.

Some of the EC 1992 legislation in such areas as standards and public procurement are already addressed in GATT agreements. Both the United States and the EC are signatories of the GATT Standards Code, entered into force on January 1, 1980, which obliges signatories to ensure that standards and certification systems are not used as barriers to trade. Signatory countries must use open procedures when developing new standards or certification systems or revising old ones and must provide an opportunity for others to comment on proposed standards and certification systems before they are finalized. The code includes enforcement or dispute settlement provisions to deal with code violations. It also promotes the adoption of relevant international standards as a basis for new national standards and encourages signatories to participate in international standards-setting organizations with a view toward harmonizing their technical regulations.

The GATT does not require that EC regulations be compatible with it but, if they are not, any GATT signatory that claims its GATT benefits have been adversely affected could ask the GATT to renegotiate concessions or other compensation.

GATT safeguard provisions include waiver procedures, which allow a GATT member to escape temporarily from negotiated GATT commitments and to impose emergency, restrictive trade measures when it can demonstrate actual or threatened serious injury to a domestic industry. The member must then notify the GATT and negotiate with affected exporting countries to arrange compensation. If EC industries encounter transitional difficulties with EC 1992, it is possible that these safeguard provisions could be invoked.

EC guidelines state that the EC will meet its international obligations and will aim to strengthen the multilateral system but will do so in accordance with the concept of balance of mutual benefits and reciprocity. In sectors that have no multilateral rules, the EC says it would be premature to extend the benefits of EC 1992 to non-EC countries automatically and unilaterally. Consequently, it will seek new international agreements but will negotiate bilaterally with its trading partners to obtain satisfactory access to their markets to compensate for the benefits that trading partners may obtain from the European single market before international agreements exist.

Role of Various U.S. Government Agencies

The U.S. government has established a program to monitor developments, work with industry, provide information, and establish federal policy on EC 1992. In 1988, a USTR-chaired interagency task force on EC 1992 was formed to identify and address EC 1992 problem areas for U.S business. The Department of Commerce has established its Single Internal Market Information Service to provide the U.S. business community with information and assistance to prepare for EC 1992. Commerce's Trade Development Bureau and the U.S. and Foreign Commercial Service also have EC 1992 activities. The Small Business Administration also has been alerting U.S. small business to look toward Europe as an export market. The State Department's embassies, consulates, and the U.S. mission to the EC have increased their reporting since the inception of the EC 1992 program. They are also monitoring the implementation of the program in EC member states and coordinating the many visits of Americans to Europe on EC 1992-related business.

Three U.S. government agencies are responsible for GATT Standards Code implementation. USTR has general responsibility for coordinating the international trade activities of federal agencies that engage in standards-related activities. Both the Departments of Commerce and Agriculture have technical offices to assist U.S. exporters in taking advantage of the Standards Code by disseminating notices of proposed foreign government standards and rules of certification systems. Interested parties can then comment on these notices through these agencies. USTR heads the U.S. delegations to trade negotiations in the GATT.

Objectives, Scope, and Methodology

At the request of Senator Max Baucus, Chairman, Subcommittee on International Trade, Senate Committee on Finance, we have assessed how EC 1992 may affect U.S. small and medium-sized merchandise exporters. This report focuses on three key concerns of U.S. exporters: product standards, testing, and certification; rules of origin; and public procurement.

In making our assessment, we reviewed documents and interviewed officials of the Departments of Commerce and State, USTR, and the Small Business Administration concerning their involvement in monitoring EC 1992 and the issues of concern to exporters. Analysts from the International Trade Commission (ITC) and the Congressional Research Service provided us with an overview of their work in the area. We met with private sector associations and small business owners to determine their views on EC 1992 and its potential impact on U.S. exporters.

We obtained information from U.S. embassy, Foreign Commercial Service, and American Chamber of Commerce officials in Brussels, Frankfurt, London, Paris, and Madrid on how doing business in Europe will change and affect U.S. exporters. We also obtained information on standards, testing, and certification issues from representatives of national standards-setting bodies in Brussels, London, Bonn, Paris, and Madrid, and one European standards-setting body.

In Brussels, officials from the U.S. mission to the EC gave us information on what steps they were taking to monitor and influence the EC 1992 process with the EC Commission. We interviewed EC Commission officials to obtain information about specific EC 1992 issues of concern to exporters. In addition, we obtained information from private sector consultants, trade association officials, and attorneys in Brussels and Frankfurt about what advice they are giving clients on how EC 1992 will change business practices in Europe.

Officials from seven U.S. state economic and trade promotion offices told us how EC 1992 was affecting their export promotion activities. We also obtained written responses to questions from 12 additional state trade promotion offices.

We obtained information from representatives of U.S. private sector associations, businesses, and think tanks, as well as a magazine publisher in New York City. We discussed standards and testing and certification with the American National Standards Institute (ANSI) and Underwriters Laboratories, Inc. (UL).

We attended congressional, Commerce, and ITC EC 1992 hearings. Finally, we obtained and analyzed numerous documents, studies, books, and reports on EC 1992.

As requested, we did not obtain written agency comments on this report, but we did discuss its contents with officials from the Departments of Commerce and State, USTR, and private sector representatives. Our work was performed in accordance with generally accepted government auditing standards from March through December 1989.

Standards, Testing, and Certification Issues

At present, U.S. exporters find it difficult to meet the various complex standards, testing, and certification requirements in different EC countries. It follows then that a key question for U.S. exporters is whether it will be easier for them to meet EC requirements under EC 1992.

The adoption of unified standards for products with health, safety, or environmental implications, known as regulated products, could be beneficial to U.S. exporters. U.S. government officials believe that economies of scale will be gained because each product will need to meet only one standard. On the other hand, if the new standards are biased against U.S. suppliers, then the U.S. competitive position could be eroded and its EC sales levels reduced while it is retooling production and seeking the necessary approvals.

Currently, most regulated products have to be tested and certified in EC countries in order to be sold in those countries. The United States hopes to reach an agreement with the EC whereby most products regulated by EC legislation that require testing and certification can be tested in the United States to fulfill EC certification requirements.

Background on Standards, Testing, and Certification

In general, standards are voluntary technical specifications that are approved by a standards-setting body. Both the United States and the EC have promoted health, safety, and environmental standards. Certification attests that a product complies with technical specifications; for some products the manufacturer can declare conformity with the standard, while others must be certified by a third party. The EC member states have national standards-setting bodies that belong to both international and Europe-wide standards-setting bodies. In the United States, standards are developed by many different organizations, one of which is also a member of international standards-setting bodies.

Standards can be classified by the intended user group, such as

- company: meant for use by a single industrial organization,
- industry: developed and promulgated by an industry for materials and products related to that industry; or
- government: such as those designed to be used by the Department of Defense or other federal government agency.

Standards can be classified by the manner in which they specify requirements such as

- performance: how a product is supposed to function, or
- design: characteristics, or how the product is to be built.

Standards are generally voluntary, however, they can become mandatory when published as part of a code or regulation. Voluntary standards typically developed and promulgated by an industry through a consensus process can become mandatory when they are referenced in government regulations. Standards can take on a de facto mandatory status when their use is required by the market for commercial reasons.

One of the prime objectives of standards is to promote economy in human effort, materials, and energy in the production and exchange of goods. Standards are used to prevent deceptive practices and assure adequate and consistent quality of goods and services. They also promote the removal of barriers caused by different national practices. Commerce's National Institute of Standards and Technology (NIST) believes that standards often provide the basis for buyer-seller transactions and thus have a great impact on companies and nations.

The U.S. standards community and the EC both subscribe to the international view of certification as a process by which the producer or certifier attests that a product, service, or person satisfies the requirements of the referenced standard. Two of the principal purposes of certification are to (1) identify the product, service, or person as meeting the specific standard, and (2) ensure that the product, service, or person does conform and will continue to conform to the requirements of the standard. The EC and the United States use two types of certification—self-certification, whereby the manufacturer uses his mark, symbol, or statement to tell the consumer that the product meets a specific standard, and third-party certification, which is normally performed by an outside organization that owns and controls a certification mark.

Standards-setting organizations include those that solely develop standards; those that test and certify products; trade associations; and professional, technical, and building code organizations. In the United States alone, approximately 30,000 current voluntary standards have been developed by more than 400 organizations. These do not include procurement specifications used by government procurement authorities or mandatory codes, rules, and regulations containing standards used at various government levels in the United States.

Current Situation in the EC for U.S. Exporters

According to the ITC, three different types of technical trade barriers currently exist in the EC.

1. Differences in voluntary standards or specifications regarding product form, function, and compatibility and/or interchangeability with other products. These differences are usually defined as voluntary, but they are often used by procurement authorities and can attain a de facto mandatory status.

2. Barriers created by incompatible technical regulations. These are usually mandatory standards contained in health, safety or environmental protection regulations. Noncompliance with these standards makes import of a product illegal.

3. Differences in product-testing procedures. This often forces a manufacturer to repeat tests in the importing country that had already been made in the producing country and can cause extra paperwork and costly delays.

Most current standards being used in EC countries were formulated or adopted by the national standards bodies in each member state. The EC has some standards of its own formulated under the "old approach," whereby technical standards were written directly into EC legislation; however, most standards are national ones, and U.S. exporters, as a practical matter, currently must meet these national standards in each country to sell their products in that country. This sometimes necessitates costly modifications to products. Even where standards are similar, lengthy delays can be caused by the lack of mutual recognition of testing and certification between EC member states. As one U.S. industry official told us, it is common for a product to be allowed into one EC country but not into another.

U.S. testing and certification laboratories do have some agreements with their EC counterparts. For example, UL, a large U.S. standards, testing, and certification organization, has agreements with some of its counterparts in Europe to test to national requirements and mutually accept test data for a limited number of products. UL also has a Technical Assistance to Exporters program to help manufacturers understand and comply with foreign national and international certification requirements, standards, and practices before they begin to obtain overseas product certification. UL offers technical information for all EC countries.

EC Adoption of Existing International Standards

The International Standards Organization (ISO), the world's largest international standards body, covers all fields except electrical and electronic standards, which are covered by the International Electrotechnical Commission (IEC). Both organizations carry out their work through many technical groups. As of early 1988, ISO and IEC had published over 6,000 and 1,800 standards, respectively. The majority of ISO and IEC member bodies are governmental institutions.

In Europe, each country has a national standards-setting body that provides representation to European-wide standards-setting organizations. The European Committee for Standardization (CEN) and the European Committee for Electrotechnical Standardization (CENELEC) are made up of all EC and European Free Trade Association members.[1] A CEN official told us that observer status for non-member countries does not exist in either CEN or CENELEC rules; therefore, the United States cannot be an observer. All CEN/CENELEC members are also members of ISO and IEC.

CEN and CENELEC's policy is to base their work as much as possible on international standardization organization results. The international standard may be adopted without any changes or modified to meet European market needs. Once CEN or CENELEC has begun work on a European standard, all national committees are required to stop any national work on the same subject until these two standardization committees finish their work.

The European Telecommunications Standards Institute (ETSI) is an autonomous body set up in 1988 to develop telecommunications standards in Europe. ETSI requires that its members be based in one of 20 European Telecommunications Conference countries. Membership in ETSI is open to non-governmental bodies. Unlike CEN/CENELEC, ETSI allows non-member organizations to obtain observer status, conveying the right to speak but not to vote.

According to an NIST official, the high percentage of international standards that have been adopted as national standards by EC member state standards-setting bodies is facilitating the consolidation or "harmonization" of European standards. ISO and IEC standards now comprise 43 percent of Danish standards, 37 percent of French standards, 22 percent of Dutch standards, 16 percent of British standards, and 5 percent of German standards. By contrast, less than half of 1 percent of ISO and IEC

[1]The European Free Trade Association consists of Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

standards have been formally adopted as American National Standards, but this is not representative because many ISO and IEC standards are based on U.S. technology, especially in photographic materials, information technology, aerospace, petroleum, plastics, oil and gas, packaging, and banking.

ANSI coordinates and approves voluntary standards in the United States. ANSI is a private nonprofit federation of some 250 organizations that designates standards set by these organizations as American National Standards after determining that the standards were developed and approved in accordance with its consensus procedures. ANSI also coordinates and provides the infrastructure for U.S. participation in ISO and IEC.

In the past the EC member state standards-setting bodies had been more involved than the United States in international standards setting. For example, EC countries chair 70 to 75 percent of the ISO secretariats, while the United States chairs 12 percent. However, ANSI officials told us that the U.S. secretariats are in areas that are important to the United States such as fiber optics, information technology, aerospace, petroleum, plastics, and banking. According to ANSI, which is the U.S. representative to the international standards organization, the ISO secretariats the United States holds produce 27 percent of ISO standards. In this way, according to another industry official, the United States holds more ISO/IEC secretariats than any other individual country. U.S. government officials believe that the United States must become more aggressively involved in ISO and IEC if it is to maintain or to increase its penetration of foreign markets.

Situation for U.S. Exporters in the EC 1992 Environment

According to an EC Commission standards official, the approach to product standards setting proposed by the EC's White Paper has two guiding principles: (1) harmonization, whereby all member states will use the same standard for products regulated by the EC—those with health, safety, or environmental implications, and (2) mutual recognition, whereby each EC country will recognize other EC countries' standards for products not regulated by the EC—those not covered by harmonized standards.

For products regulated by the EC, the EC will adopt measures laying out essential requirements that products must meet, and the European standards-setting bodies will develop detailed standards sufficient to ensure that products meet the essential requirements. Compliance with these

standards will not be mandatory, but an EC standards official told us their use will put a producer on the "fast track" to approval. The EC claims that products that show they meet the essential requirements via CEN/CENELEC or other standards will be able to be sold freely throughout the EC. Under the EC's guidelines, U.S. exporters will be able to market their products freely throughout the EC if (1) they meet a harmonized European standard, or (2) they can prove conformity to the essential requirements.

For products not regulated by the EC, U.S. exporters will still have to meet the national standards of the importing country where they exist. Under the mutual recognition principle, products legally meeting one member state's standard, and/or accepted for sale in one member state, should then be free to move throughout the EC.

Several decisions since 1979 by the European Court of Justice have helped to facilitate the removal of technical barriers to trade in the EC. In its landmark Cassis de Dijon decision, the Court ruled that Germany could not keep out a French beverage because it did not satisfy German alcohol content standards, since the product was legally produced in France. In this case, and in subsequent interpretations, the Court accepted the principle that a product legally sold in one member state must have the right to move freely throughout the EC unless an importing member country could demonstrate that its exclusion was based on genuine issues of public health and safety.

In one U.S. business association's view, the decision facilitated movement toward EC 1992 because it meant that EC member countries had to accept some expeditious means of developing EC-wide minimum product standards. In subsequent decisions involving British and French standards for milk, German standards for beer, and Italian standards for pasta, the Court has continued to uphold the principle it set forth in its Cassis de Dijon decision.

U.S. Access to EC Standards-Setting Process

Public and private sector U.S. delegations are working with the EC Commission and CEN/CENELEC to make the European standards-setting process more transparent and more open to non-European participants. In early 1989, CEN/CENELEC agreed to provide ANSI with monthly CEN/CENELEC work plans. ANSI began a work plan subscriber service in April 1989 to inform interested U.S. firms about CEN/CENELEC standards-setting activities.

In May 1989, Commerce and the EC Commission issued a joint communique announcing the establishment of a dialogue on standards issues of mutual concern. In June 1989, the two European standardization committees issued a memo to their members discussing their commitment to using international standards. The organizations encouraged the acceptance of comments on their work from non-member countries under the auspices of the relevant national member body that belongs to ISO/IEC. For the United States, the relevant body would be ANSI. In July 1989, ANSI agreed to share more information with CEN/CENELEC, so ANSI now compiles, to the extent possible, a work plan similar to the one CEN has been providing to ANSI and provides it to the two European standardization committees.

In early 1989, ANSI requested observer status in CEN/CENELEC, but it was denied. ANSI then proposed that international standardization organization technical committee secretariats participate in CEN/CENELEC European standards development. In other words, ISO/IEC would be given observer status at CEN/CENELEC. The two European standardization committees also denied this proposal; however, according to Commerce, CEN/CENELEC said that ISO/IEC members could work with CEN/CENELEC to develop a work plan for a standard, but these members could not participate in the standards-drafting process. In August, the two European standardization committees reached an agreement with ISO/IEC to exchange work plans and technical documents. As a member of ISO and IEC, ANSI has access to these documents.

According to CEN and CENELEC, they will adopt international standards where they exist and where they believe it is appropriate. It is only where international standards do not exist and are unlikely to emerge in the foreseeable future that CEN/CENELEC will use another basis for their standards harmonization. In June 1989, CEN/CENELEC proposed that, for all new European standards activities, if ISO/IEC will complete the necessary work within the required time frame, CEN/CENELEC will adopt the resulting international standard.

ANSI believes much progress has been made in terms of improving the transparency of the CEN/CENELEC standards-setting process, and now the United States needs to use it to its best advantage. U.S. public and private sector officials believe that CEN/CENELEC's willingness to adopt international standards is another step toward improving U.S. access to the EC market, and now the United States must hold CEN/CENELEC to that policy.

U.S. Access to EC Testing and Certification

In July 1989, the EC Commission approved a draft testing and certification document, known as the EC's global approach, which lays out proposals for testing and certification in the EC in the EC 1992 environment. The proposal, which aims to set the ground rules for future procedures in the regulated sector, states that the EC will require mutual recognition of test results by "notified bodies"—those meeting EC-specified criteria based usually on ISO/IEC guides—for products covered by EC measures. The document proposes a modular approach to conformity assessment procedures. It is expected that the EC legislative measures will delineate which module or modules can be used to prove conformity for products in that category.

An EC Commission standards official told us that, through the EC's new approach to standards, testing, and certification, the EC wants to increase the flexibility that manufacturers have in meeting requirements. For many products, if a manufacturer produces its product in accordance with the harmonized European standard, and the EC allows a manufacturer's declaration of conformity for that product, the manufacturer will be able to self-certify that it meets the essential requirements of the EC measures. Manufacturers that do not produce to the European standard must have their products tested and certified by a third party to ensure that they meet the essential requirements. Testing will be carried out by testing organizations "notified" by member states that they conform to the EC criteria for accreditation as a certification body.

Products that present a substantial risk to health and safety will be subject to more stringent requirements. Manufacturers will have to register their quality assurance programs or obtain pre-marketing-type approval from a "notified body."

Under the GATT Standards Code, the EC is obligated to grant products produced in non-EC countries access to its certification process on the same basis as its own producers. In the July 1989 testing and certification proposal, the EC Commission states that products from non-EC countries will be given the same choices of means to demonstrate conformity with EC directives as EC producers.

It is not clear at this time whether all U.S.-made products that require certification will have to be tested by an EC-accredited body. The EC Commission proposal provides for negotiations with non-EC governments to enable EC "notified bodies" to accept test data and certificates from non-EC testing bodies. For products not regulated by the EC, existing bilateral agreements between an EC member state government

or private organizations and a third country entity may or may not be subject to EC review and approval. For products regulated by the EC, it is possible that such bilateral agreements could be nullified, but, in principle, it is hoped they will also be transformed into EC-wide agreements. According to U.S. government officials, EC Commission officials have stated they do not want to disrupt existing trade covered by bilateral agreements.

With regard to testing and certification of products not regulated by the EC, the EC's philosophy is that mutual confidence is better developed through accreditation of organizations to do testing and certification and self-policing than through legislation. Therefore, for products to which no measures apply, the EC Commission is encouraging testing and certification bodies to follow the same criteria the EC had laid out to certify "notified bodies."

In May 1989, the United States and the EC Commission also agreed that the principles of openness and transparency should apply for testing and certification and reaffirmed that products imported into the EC will have the same access to testing and certification procedures as EC products. In addition, the United States hopes to reach agreements with the EC for U.S. products destined for sale in the EC to be tested in the United States.

Implications for U.S. Exporters of the New Standards, Testing, and Certification Requirements

According to one association, in principle the adoption of common standards is widely seen by U.S. companies in Europe as a major benefit. U.S. companies with production facilities in Europe believe they will be able to rationalize production across national frontiers to a much greater degree than at present. U.S. exporters may achieve comparable benefits because they are now assured that complying with whatever standard is adopted for a product will provide access to the entire EC market.

On the other hand, according to the same association, concerns have been expressed that only products meeting national standards criteria and receiving the mark of a national standards body can be sold in some markets. Although a product might meet all legal requirements for sale in an EC member state, it might not meet commercial requirements. According to one business association, insurability rules can be used to keep out products not meeting a specified national standard. For example, an electrical product meeting all EC legal requirements for sale in that country might not be able to get insurance. A product meeting all legal requirements for sale might be incompatible with other units in a

system and therefore not be saleable commercially. Consumer resistance to products that do not have that country's national mark is another way in which products meeting legal requirements might not find commercial acceptance.

In Europe, for certain industries, such as physical plants and machinery, companies set their own standards that, in turn, become the national standards. According to this association, concerns exist in the United States that some European companies with rigid standards will seek to protect their EC market position by having their national standard adopted on an EC-wide basis. On the other hand, the need to achieve consensus within the CEN/CENELEC process should mitigate this. In this association's view, the major concern of U.S. companies is that CEN/CENELEC will adopt standards that are not used in the United States, thus in fact excluding or hindering the competitiveness of U.S. products, or necessitating costly modifications to sell in the EC market.

The adoption of different standards from those used in the United States creates two problems: (1) the need for extensive proof that the U.S. product meets the EC's essential requirements; and (2) the fact that even if the product meets the essential requirements, consumers might not accept it because it is nonstandard. One way partially to resolve this problem is for CEN/CENELEC voluntarily to adopt and for U.S. manufacturers to use international standards. Another way is to make use of the access the United States has to the European standards-setting process to hold CEN/CENELEC accountable to their commitment to using international standards and their willingness to listen to presentations from nonmember experts.

In addition, Commerce has received reports from various industries of a reduction of European work in certain ISO/IEC committees presumably because their time is being spent on CEN/CENELEC work instead. If CEN/CENELEC plan to hold to their commitment to adopt those international standards that can be completed within the required time frame, then a reduction in European attention to its international standards-setting obligations could be an impediment to EC adoption of international standards.

According to an EC Commission standards official, CEN/CENELEC are harmonizing only about 10 to 20 percent of the products covered by standards in Europe—those affecting health, safety, and the environment. The mandate from the Cassis de Dijon decision should allow all other products' meeting one member state's national standards to be sold in all

other member states. It remains to be seen how well this will work and how much the situation will really change for exporters to the EC.

Through new standards, testing, and certification regulations, the EC is endeavoring to create a more open market in which goods can flow more freely between member states. It is not yet clear, however, how the market will react to increased product availability made possible by harmonization and mutual recognition. Although a product might meet all of the EC's requirements to be sold in a particular member state, it will remain the consumer's prerogative whether or not to purchase it.

As one Foreign Commercial Service officer told us, although the EC will legally be one market, it will still be made up of different cultures and languages—what sells in one country or region will not necessarily sell in another. This idea was reinforced at Export '89, the U.S.-EC Small Business Trade Congress in October in Frankfurt, West Germany. Several EC officials reminded U.S. participants that a harmonized Europe did not mean a homogenized Europe.

Questions that remain to be answered are: How much will the new testing and certification procedures differ from the old, and will it cost U.S. exporters more to market their products in the EC in the future? U.S. exporters probably will not be any worse off under EC 1992, and they could be better off. Although U.S. manufacturers have expressed concern over the possible requirement of quality assurance testing, it is also not clear how this requirement for certain products will affect testing and certification of U.S.-made products. An official from one European national standards-setting body told us that the quality assurance system is voluntary—it is market-driven, not legally required.

Currently, bilateral agreements exist for testing only a few of the U.S.-made products sold in Europe. Even if the EC continues to require most products to be tested in Europe, the fact that European certification enables a product to move freely throughout the EC should save U.S. exporters the cost of getting products tested in each country. What is not yet clear is how the Europeans will assess the conformity of U.S.-made products to the European standards or to EC essential requirements. According to one industry official, this is where discrimination and delays could occur. Both U.S. government and private sector representatives have expressed concern over whether the United States is ready to extend bilateral agreements currently in place with one member state to the other 11. The EC will need to prove to the United States

that the certification bodies in the other EC countries are competent before the agreements are extended EC-wide.

The certification systems in the EC and the United States are very different. The EC's global approach to testing and certification calls for reciprocal access to markets in any agreements negotiated with non-member countries. Because the EC is opening its market completely, this requirement means the United States would have to do the same. Industry and business association officials have expressed concern over whether the United States can or would want to provide reciprocal access. The United States can provide national treatment, whereby the EC firms would receive access to testing and certification in the United States on the same basis as U.S. firms do; however, there is some question as to whether the U.S. private sector wants mutual recognition of laboratories. In addition, because most testing and certification are done privately in the United States, it is doubtful that the U.S. government could negotiate an agreement covering U.S. private sector testing and certification.

Consumer acceptance of the EC mark for products' falling under harmonized standards will ultimately determine the success of mutual recognition of testing and certification between EC member states. Will this mark be accepted by consumers in individual member states, or will consumers still want their country's national mark affixed to the product? If the latter, mutual recognition of testing and certification will have a limited impact not only on U.S. exporters but also on anyone shipping products between EC member states.

Concerns also exist over whether declarations of conformity by U.S. manufacturers will be accorded the same treatment as those by European manufacturers and whether the use of the EC mark by U.S. manufacturers will be restricted. In addition, the increasing emphasis on quality assurance in the proposed EC certification process could be a problem for U.S. manufacturers. It is not clear whether certification bodies will insist that it is not possible for them to assess factories outside their regions.

One provision of UL's agreements with manufacturers requires that the manufacturer allow UL to inspect the factory, since UL believes it is not possible to determine whether products meet established requirements without evaluating the components and the finished product on the production line. This is similar to the quality assurance requirements in the EC's global approach to testing and certification. A UL official indicated

that he believes U.S. manufacturers already exporting to Europe probably will not have to modify their process too much to fulfill the EC's quality assurance requirements, but it might be more difficult for those who have not previously exported to Europe.

On-Going and Possible U.S. Actions to Allay U.S. Exporters' Concerns

A major EC 1992-related concern of U.S. exporters is the need for more accurate and timely information. Small and medium-sized U.S. exporters without offices in Europe tend to rely heavily on others for the information they need to make business decisions regarding the EC market.

A CEN official explained to us that all CEN members are required to notify each other of their standards development work. EC Directive 83/189 established an information procedure that permits drafts of national standards to be examined to determine their compatibility with the principle of free circulation of goods within the EC. Member states submit draft standards to CEN, which compiles the information and distributes it to other CEN members. The United States may be able to obtain more timely information about EC standards-setting activities through this procedure. This CEN official suggested that the U.S. government could ask the EC Commission to allow CEN to distribute this information to others.

The CEN official also suggested that, to get more information, U.S. exporters should ask ANSI for the information on standards-setting activities that CEN is already providing in monthly work plans. CEN itself, however, is not equipped to provide information to individual U.S. exporter requests. U.S. exporters can submit comments and concerns through ANSI.

According to the National Association of Manufacturers,

- U.S. companies in Europe should participate in national and EC-wide standards-setting bodies;
- U.S. companies should be familiar with existing ISO/IEC standards and be prepared to implement them for products sold in Europe;
- U.S. companies should contact ANSI for information on proposed standards relevant to them;
- in developing U.S. national standards and in participating in international standards bodies, U.S. companies should seek to ensure a maximum level of conformity between international standards and national standards in Europe, North America, and Asia; and

- U.S. companies should identify obstacles related to national application and use of standards that may inhibit distribution even of those products conforming to new EC-wide standards.

Several standards officials indicated to us that increased U.S. emphasis on the use of international standards would make it easier to meet European standards in the future. Increased participation in international standards-setting activity would indirectly enable the United States to have more influence on CEN/CENELEC standards. NIST officials believe the U.S. government should encourage U.S. manufacturers to use international standards and to produce to market requirements instead of trying to get the market to change to U.S. requirements.

ANSI officials believe that both the public and private sectors should be more involved in alerting manufacturers to the importance of international standards to remain competitive. Because CEN/CENELEC have agreed to use international standards where appropriate, they said it is in U.S. manufacturers' best interests to use them also in order to sell in Europe.

Conclusions

Under EC 1992, a U.S. exporter will have to meet only one standard and have its product tested in one EC member state to sell throughout the EC. Therefore, U.S. exporters will probably not be any worse off than they are under the current system and could be much better off.

It is still possible that different commercial means could be used in EC countries, such as insurance requirements, consumer resistance, or delays in certification, to try to keep non-national products out of EC national markets. Both the U.S. public and private sectors recognize the need to continue to monitor and try to influence developments in the standards, testing, and certification areas; some ways to accomplish this better have been identified.

Rules of Origin Issues

The ITC defines rules of origin as laws, regulations, and administrative practices that are applied to ascribe a country of origin to goods in international trade. They are applied in the customs procedures of importing countries to assure that trade programs and regulations are properly implemented. Rules of origin are used for such purposes as granting most-favored-nation tariff status; implementing preferential trade programs; applying antidumping duty policies; complying with marking statutes; and reporting statistical data on international trade. They can also be used to determine eligibility to sell to a government entity that has buy-national procurement restrictions. Local content requirements specify the level of investment necessary to market a product in a particular country.

The importance of rules of origin has grown as finished products increasingly incorporate parts and processing from more than one country and as preferential agreements have become more common in international trade. The internationalization of production has made it difficult to assign origin unambiguously and to restrict preferential trade programs to the intended beneficiaries.

The determination of origin has been a source of contention in U.S.-EC trade relations since the early 1970s, when the EC adopted special rules of origin to implement its free trade agreement with the European Free Trade Association. According to U.S. government officials, until recently the EC resisted U.S. efforts to reach an international agreement on a common definition of rules of origin in the GATT. However, the EC 1992 program has increased the visibility of origin-related issues. There is growing concern in the United States that the EC will adopt rules of origin that discriminate against non-EC products. According to EC Commission officials, the EC generally maintains no official local content policy, but it has recently stipulated value-added percentage origin rules in connection with antidumping regulations.

The EC Commission origin determinations concerning semiconductors and photocopiers, made since the inception of the EC 1992 program in 1985, are of particular concern to the United States. U.S. suppliers in the high technology and electronics industries have expressed concern that U.S. components could be "sourced out" of certain products as third-country manufacturers based in Europe attempt to comply with EC rules of origin. U.S. auto parts suppliers expressed similar fears when the EC recently considered a value-added origin rule in the application of quantitative restrictions on Japanese automobiles.

According to U.S. government officials, fears of being "sourced out" of final products manufactured by third-country firms could lead U.S. companies to make costly capital investments in Europe when they are not ready to do so from a marketing or sales perspective. In addition, the uncertainty surrounding the application of rules of origin in EC 1992 could lead to increased U.S. investment in the EC by companies' fearing loss of access to this market. Thus, U.S. policymakers expressed concern that EC rules of origin, particularly value-added origin rules, may pressure U.S. companies to transfer jobs and technology to Europe.

U.S. government and industry officials worry that the EC may manipulate rules of origin in some sectors for trade and industrial policy purposes. Because rules of origin are applied on a product-by-product basis, the EC could also yield to political pressures to protect certain industries during the transition to 1992. USTR and private sector officials claim that the lack of transparency, the unpredictability, and the arbitrary nature of EC rules of origin could discourage U.S. companies from exporting to Europe.

Background

According to the ITC, country of origin determinations based on substantial transformation, change of tariff heading, and value-added tests may be applied, independently or in combination, depending on the product and trade policy of the importing country. In the case of the EC, the Commission sets the trade policy that is implemented by the member states.

Typically, the substantial transformation rule confers origin on the last country of manufacture, which does not necessarily indicate the relative economic contributions of the producing countries. The change-of-tariff-heading principle confers origin on a product if it is sufficiently transformed in a given country to merit a change in its title under the tariff classification system. The value-added principle calls for a certain minimum percentage of the value of a final product to be added in the country that is considered the country of origin. The calculation of value added may include both the value of the materials and components used to produce an article and the direct processing costs.

The EC applies value-added origin rules for the administration of industrial policies, voluntary export restraints, statistical monitoring, and public procurement. For example, under the proposed EC content requirements for public procurement in the sectors of water, energy,

transport, and telecommunications, suppliers should receive nondiscriminatory access to EC purchasers if their bids contain at least 50 percent EC content.

Existing Agreements and Regulations on Rules of Origin

No internationally accepted definition of rules of origin exists among the GATT signatories nor is there a uniform set of procedures for applying them. However, the application of many of GATT's provisions recognizes the need for a determination of origin, and a GATT article contains guidelines on origin marking requirements.

The basis for the application of recent EC rules of origin included several existing agreements and regulations, such as the 1973 Kyoto Customs Convention, the 1968 EC Council Regulation 802/68, and the GATT Antidumping Code of 1979. A USTR official stated that, in practice, both the United States and the EC have complex and sometimes unpredictable processes for determining the origin of different products.

The Kyoto Customs Convention Annex D.1, entered into force in 1977, states that customs services shall employ two basic criteria in determining rules of origin: (1) whether the goods have been wholly produced in one country, where only one country enters into consideration in attributing origin and (2) whether substantial transformation has occurred involving two or more countries. The United States is a signatory to the Kyoto Convention but did not sign Annex D.1 because at the time U.S. officials believed that it more closely reflected the European system for determining origin than the U.S. system. Some 22 others signed the Annex, including the EC.

EC Regulation 802/68, entered into force in June 1968, further defines the concept of last substantial transformation and serves as the guideline for subsequent EC legislation on the origin of goods. This regulation states that the origin of a product manufactured in two or more countries shall be determined by the country in which the last substantial process or operation that is economically justified was performed. In addition, a process carried out solely to circumvent EC antidumping regulations will not confer origin.

The GATT Antidumping Code of 1979, the basis for applying antidumping and countervailing duties, contains no definition or procedural guidelines for rules of origin. Therefore, each GATT signatory may apply its own system to determine the origin of imported products for Code purposes.

Recent EC Legislation May Change Policy on Rules of Origin

Within the last two years, the EC has adopted new criteria to determine the origin of semiconductors, photocopiers, and computer printers. These new criteria are based on manufacturing processes as well as on value-added requirements. A 45-percent value-added requirement is currently applied to certain consumer electronic goods, such as tape recorders, radios, and televisions. The EC has initiated antidumping investigations against Japanese typewriters, electronic scales, and computer printers. In addition, some EC member states have considered new value-added origin rules for automobiles, that are subject to quantitative restrictions and 50-percent content provisions for products to be treated as EC origin in certain public procurement bids.

A U.S. business association official commented that while these measures alone do not indicate a fundamental change in the EC's position on origin, they could signal more changes to come. Among U.S. exporters, representatives of the electronics industry have been the most vocal in expressing their concerns about EC policies on rules of origin.

Semiconductors

According to a USTR official, the February 1989 EC regulation on determining the origin of integrated circuits and assembly provisions poses a potential threat to U.S. semiconductor manufacturers. The new rule of origin for integrated circuits states that the criterion for the origin of semiconductors is no longer the assembly process but the diffusion or wafer fabrication process. To obtain EC-origin, semiconductors will now have to contain silicon chips that are diffused in the EC; otherwise, they will be subject to a 14-percent tariff. According to semiconductor representatives, this change makes it more difficult for foreign-based companies to obtain EC-origin for their semiconductors.

Another EC regulation, known as the "screwdriver assembly rule," states that antidumping duties may be imposed on certain imported products assembled and sold in the EC that have been considered to have been dumped in the past, unless at least 40 percent of their parts and materials were obtained outside of the dumping country. No more than 60 percent of the value of a product's parts and materials may originate in the dumping country. The provision also states that the EC will take into account, on a case-by-case basis, the variable costs incurred in the operation and the research and development carried out and applied within the EC.

According to U.S. government and industry representatives, EC rules of origin, coupled with screwdriver assembly measures, create a strong

influence on foreign firms to use components from an EC member state rather than from another country to avoid dumping duties and may constitute nontariff barriers to trade for semiconductors. For example, although the EC guidance calls for 45-percent non-Japanese value in printed circuit boards, semiconductor industry representatives claim that Japanese manufacturers are apparently being told that the circuit board component of their computer printers must contain at least 45-percent EC value for the printer to obtain EC origin. Only by obtaining EC origin for the boards can Japanese manufacturers assure at least 40-percent non-Japanese value in the finished printer and avoid dumping duties under the screwdriver assembly rule. The Japanese are reportedly attempting to ensure the European origin of their circuit boards by replacing U.S. semiconductors with European semiconductors, thus avoiding dumping duties without reducing the level of Japanese content in their printers. At the same time, the EC succeeds in increasing the market for its own semiconductors. Commerce and industry officials believe this is one example of an EC-origin decision with local content implications that, taken together with other rules of origin, compels local investment.

Not only U.S. semiconductor suppliers but also U.S. manufacturers of final products that use semiconductors may feel the effects of EC antidumping measures. For example, U.S. high tech manufacturers that purchase many of their components from Japan and the newly industrialized countries run the risk of being subject to antidumping duties aimed at these countries.

Both the diffusion rule of origin and the value-added rule of origin in the screwdriver assembly provision put pressure on U.S. semiconductor producers to manufacture in the EC. U.S. companies can avoid the direct impact of the 14-percent tariff and the indirect impact of the screwdriver assembly rule by ensuring EC origin of their own products.

It remains to be seen whether the EC origin and value-added requirements affecting U.S. semiconductor manufacturers will be followed by EC initiatives with similar effects on other U.S. industries.

Other Electronic Products

A case involving a Japanese manufacturer of photocopiers assembled in the United States illustrates how the EC rules of origin, combined with EC antidumping policies, might affect U.S. economic interests. The Japanese firm was assembling photocopiers in its California plant, then shipping them to the EC as products of U.S. origin, thus avoiding 20-percent

dumping duties on photocopiers exported directly from Japan. In early 1989, the EC questioned the origin of these U.S.-assembled copiers. When EC officials visited the plant in California to determine whether it should be considered a substantial operation, they found that U.S. assembly and manufacturing fell below the 45-percent value-added requirement and therefore decided to apply 20-percent antidumping duties unless the firm increased the non-Japanese content of these copiers. The firm subsequently increased its U.S. operations to the point where dumping duties no longer apply.

Meanwhile, in an effort to prevent future disputes of this nature, the EC adopted a definition outlining the operations that do not confer origin on foreign-made photocopiers. These operations include assembly of photocopying apparatus accompanied by the manufacture of the harness, drum, rollers, side plates, roller bearing, screws, and nuts. The United States objected to the EC's adoption of a negative rule of origin, taking the position that rules of origin should be based on a positive standard to the maximum extent possible—defining what does confer origin as opposed to what does not. In addition, U.S. officials fear a possible loss of Japanese investment in the United States due to stricter EC origin rules for photocopiers and other Japanese products manufactured or assembled here.

Within the last two years, EC antidumping duties have been levied against Japanese typewriters, electronic scales, and photocopiers assembled in the EC. Other EC antidumping investigations are currently in progress for certain Japanese computer printers. Since the imposition of these duties, most of the affected Japanese firms have undertaken to raise the EC content of their products progressively.

Quantitative Restrictions

As borders open between EC member states, enforcement of the approximately 1,000 quotas and other import restrictions maintained by individual member states will become impossible. Consequently, the EC faces a choice between either phasing out these restrictions after 1992 or transforming them into EC-wide restrictions. If the EC tries to protect industries, it is uncertain whether the EC will institute specific quotas for different products, such as automobiles and electronics, or whether it will change origin rules to protect those industries now subject to quotas.

According to a U.S. international business association, the EC will likely maintain some transitional rules restricting imports in an effort to protect some critical industries, such as automobiles and consumer electronics. Although these measures will be directed at the Japanese, U.S. officials are not sure how the EC will define "transitional" and how these measures will affect U.S. trade.

France, Italy, Britain, Spain, and Portugal import a limited number of Japanese autos annually. Currently, Japanese vehicles account for about 11 percent of the total EC automobile market.

According to recent EC statements, it appears likely that the EC will propose a voluntary export restraint agreement with Japan to replace current individual member state restrictions that would stay in effect for a limited period until European manufacturers have had time to adjust to an open market. It is possible that Japan will attempt to avoid the impact of these voluntary restrictions by exporting autos manufactured in its U.S. plants. For example, Honda plans to start exporting cars from its U.S. plant by 1991. A U.S. business association official expressed concern that the origin of cars made in the Honda plant could be questioned, as in the photocopier case. In this official's view, if, in the EC's estimation, the U.S.-made Hondas do not contain sufficient U.S. content, they may be considered Japanese and thus subject to restrictions. At stake for the United States are the economic and employment benefits of Japanese investment in U.S. manufacturing facilities. According to a State Department official, however, because it is up to the Japanese to monitor and abide by a voluntary agreement, the EC could not restrict imports of Japanese cars from the United States without adopting a different piece of legislation.

The U.S. auto parts supply industry, with a $1.4 billion market in Europe, has expressed concern about how the EC will apply value-added origin rules to determine which Japanese vehicles will be subject to restrictions. EC members already have used local content rules to pressure Japanese auto manufacturers to transfer investment and technology to Europe and to buy from local suppliers. For example, the United Kingdom has convinced three Japanese firms to open plants there rather than to export from Japan. Such rules could force Japanese manufacturers to increase their use of EC components at the expense of U.S. and other third-country suppliers.

Implications of Recent EC Decisions on Rules of Origin for U.S. Trade Interests

For certain sectors in which the EC would like to improve its competitiveness, such as high technology, consumer electronics, telecommunications, and automobiles, rules of origin, particularly value-added origin rules, could be used as an incentive for U.S. and third-country firms to increase the European content of their products and services. For example, U.S. business owners have demonstrated the potential for U.S.-made components to be sourced out of Japanese final products, particularly in the computer, consumer electronics, and auto parts industries. In order to maintain market access, some U.S. suppliers feel pressured to make costly capital investments in Europe.

On the other hand, according to a U.S. business association official, the relationship between exporting and investment in the EC is not a "zero-sum" game, as some fear. He believes that increased U.S. investment in the EC is likely to draw increased U.S. exports rather than displace existing exports. For example, when a U.S. company expands its investment abroad it will typically rely on U.S. goods, such as computers, semiconductors, and scientific instruments, or use U.S.-made components in the final product. In fact, the sales of many small U.S. exporters in the EC involve components of products sold by larger U.S. companies with operations and investment in Europe. Recent Commerce statistics show that about 34 percent of all U.S. exports to the EC go directly to the affiliates of U.S. companies with direct investments there.

U.S. exporters complain about the lack of transparency and the unpredictability of the EC's rules of origin system. Procedural rules for application of antidumping duties are reportedly less formal and, according to many foreign exporters, more political than those used in the United States. An EC official explained that origin determinations have to be negotiated on a product-by-product basis. For example, the effective value-added rates or other criteria used to determine the origin of photocopiers, semiconductors, and televisions are all different. Additional rules are being considered for computer printers and petroleum products. These value-added requirements will influence how the EC administers tariffs, antidumping measures, and related screwdriver assembly provisions.

In addition, the EC has the ability to waive the application of dumping duties depending on the amount of research and development that took place within the EC. According to one association official, these waivers

are a matter of total administrative discretion. This problem is exacerbated by the fact that there is no multilateral recourse for settling disputes on rules of origin. USTR officials claim that the lack of transparency, the unpredictability, and the arbitrary nature of EC rules of origin could discourage U.S. companies from exporting to Europe. Alternatively, uncertainty about continued access to the EC market could lead to decisions to invest in the EC based on a desire to avoid trade barriers rather than on market considerations.

On the positive side, U.S. auto parts manufacturers with operations in the EC may have opportunities for sales to European-based Japanese customers as Japanese firms expand their EC facilities. On the negative side, industry experts point to the danger that EC auto trade policy could (1) divert some Japanese auto exports to non-EC markets, including the United States, (2) discourage large-scale imports of Japanese autos manufactured in the United States, and/or (3) limit exports of U.S.-made original equipment parts if EC rule of origin requirements are set at an excessive level.

Procedural ambiguities, combined with the apparent EC emphasis on such industries as high technology, electronics, and automobiles, have led some U.S. observers to suspect that the EC is using origin, particularly value-added origin rules, as instruments of protectionist trade policy. They are concerned that, with such wide discretion to apply rules of origin on a product-by-product basis, the EC could yield to political pressures to protect these critical industries.

A State Department official warned that U.S. government statements that overemphasize the threat of "fortress Europe" could have the same effect as EC origin regulations in terms of shifting U.S. investment to Europe. He believes that the U.S. government should consciously avoid policy statements or programs that could lead U.S. companies to make investment decisions based solely on fear of or uncertainty about EC 1992. U.S. international business association officials believe that U.S. investment decisions should be connected to market strategies, not to regulatory concerns. Similarly, an EC official said that U.S. business decisions should be based on economic considerations, not on fear. In general, government and private sector officials we met with believe that if U.S. companies use sound business judgment in their EC investment decisions, the EC should continue to be an important U.S. market in terms of reducing the trade deficit and improving U.S. competitiveness.

On-Going and Possible U.S. Actions to Allay U.S. Exporters' Concerns

According to industry experts, the absence of a harmonized international rule of origin system has created trade restrictions. U.S. concerns about rules of origin involve a broad range of products, including textiles, chemicals, and electronics. To address the general problems and to resolve specific problems connected with EC policies, both private sector associations and U.S. government agencies have called for an internationally accepted definition of rules of origin in the GATT. USTR's goal is to ensure that the rules of origin used in the EC are transparent and predictable and do not represent arbitrary measures employed as tools of commercial and industrial policy.

The U.S. delegation to the current round of GATT negotiations has submitted a three-part proposal on rules of origin to the GATT Negotiating Group on Non-Tariff Measures: (1) a work program for moving toward harmonization, (2) procedural rules, and (3) principles to govern their application.

In October 1989, the EC Commission issued an internal discussion document that proposes international negotiations toward greater transparency and clarity in origin rules and recognizes the need to incorporate the basic origin principles within the GATT. The document explains the EC's use of the Kyoto Convention for its origin rule practices and serves as a basis for GATT negotiations. The EC Commission envisions a GATT statement recognizing that origin rules must (1) be transparent, (2) be applied in a non-discriminatory fashion, and (3) provide legal certainty for companies.

To operate competitively in the European market, U.S. companies need to obtain available information on EC origin rules and how they will apply to specific industries and products. They need advance knowledge of proposed EC regulations to make effective production, marketing, and investment decisions.

U.S. companies have available to them several sources of information on EC origin rules.

- Commerce's Office of European Community Affairs has been monitoring and can provide information on changing origin regulations for semiconductors, printed circuit boards, photocopiers, and automobiles. This office will answer questions on rules of origin for other products on a case-by-case basis. The Office also can provide general origin information to U.S. companies interested in offshore manufacturing or assembly.

- The EC Commission delegation in Washington, DC, can provide U.S. companies with information on recently enacted EC legislation on rules of origin but generally does not give advance notice of pending legislation.
- For advance warning on new EC policies on rules of origin, industry trade associations and U.S. subsidiaries in Europe are likely to have the most up-to-date information. According to Commerce, it is difficult to stay out in front on issues relating to EC rules of origin because information often circulates informally before it is brought to the attention of the government.

Conclusions

Our review identified a few examples of how changing EC rules of origin and application of antidumping regulations could affect U.S. industry. Whether the regulations affecting U.S. semiconductors and Japanese photocopiers will become part of a more general trend is not clear. The U.S. government is continuing to monitor the EC's rules of origin policies for signs of further change.

The problems surrounding the EC's application of origin rules—lack of transparency and unpredictability—are not new, and resolution will likely be a gradual process. The U.S. government is working through the GATT negotiations to make progress on these issues. It is also trying to help U.S. businesses stay informed of changes in EC origin rules that may affect their industries in the transition to EC 1992 and beyond.

Public Procurement Issues

A key issue for U.S. exporters is the extent to which they will be able to participate effectively in the liberalized EC 1992 public procurement market. The ability of firms based outside of the EC to participate in this market will continue to depend on the EC's observance of multilateral trade rules of government procurement. The primary agreement is the 1980 GATT Agreement on Government Procurement, which established many disciplines and obligations for government procurement among its signatories. Some in the United States have been disappointed, however, with the implementation of the code and the number of opportunities created for U.S. exporters.

Current EC Public Procurement Situation

According to the EC Commission, EC member state government departments, local authorities, and public utilities tend to purchase their supplies of consumables and capital equipment primarily from domestic suppliers. Local contractors also receive the bulk of public construction projects contracts. The EC has rules that require public procurement and construction contracts to be opened up to competition from firms in other member states; however, the EC has stated that the rules have so far been inadequately applied or ignored.

According to the EC Commission, EC government leaders accepted the goal of liberalization of public purchasing and construction, and one priority of the EC 1992 program is the complete opening up of government procurement and large public sector construction projects. One reason for the high priority is the huge size of these sectors. The EC believes that more international competition in these procurement areas should lead to decisions that make better commercial and economic sense.

According to the EC Commission, EC legislation requiring public contracts to be opened to competition from firms in other member states dates back to the 1970s. The bases of the legislation are the 1971 measure on public works and construction contracts and the 1977 measure on government procurement of supplies of goods and equipment. These have subsequently been amended, but the fundamental principles are that (1) suppliers and contractors from all EC countries should have equal opportunities in bidding for public-sector contracts, and (2) tendering and award procedures should be open and above board to discourage discrimination against firms in other EC member states. Discrimination against potential or actual other EC bidders would be against the rules on intra-EC free trade.

In 1980, according to the EC Commission, the EC procurement legislation was amended to adapt EC law to the GATT Procurement Code. This extended nondiscrimination principles to all code signatories for procurement by specific government agencies.

EC procurement legislation generally commits member state governments not to practice discrimination against other EC suppliers; however, certain purchasing entities and public authority construction projects were excluded from the legislation. Hence, according to the EC Commission, EC member states have continued to give preference to domestic suppliers and contractors in these areas. The EC has acknowledged that its exclusion of public utilities has proven to be a major loophole in its legislation when it stated that the procurement legislation failed to guarantee complete transparency in tendering and award procedures. Therefore, often no way existed to detect, let alone prevent, discrimination against foreign firms.

The EC Commission believes government buying practices significantly influence patterns of production and trade. The Congressional Research Service estimated total public procurement in the EC, including government departments, local authorities, and public utilities, at $630 billion in 1987, yet only a small percentage of EC government contracts are supplied by foreign firms. For example, according to the Congressional Research Service, in 1987 imports accounted for only 0.3 percent of public contracts in Italy, compared with 19 percent of all goods consumed there.

Moreover, the water, energy, transport, and telecommunications sectors were excluded from the EC's guidelines because they presented too varied a mix of public and private ownership and control among member countries. These sectors were also excluded from the GATT Code largely because the EC lacked jurisdiction over its member states' procurements in these sectors. According to the EC Commission, public procurement in these excluded sectors in the EC was largely reserved for national companies. Such a low level of imports underscores the fact that U.S. exporters, and exporters in general, do not effectively participate in this market.

Although it appears that U.S. suppliers have had limited success selling to EC government purchasers, access to the market is important to a number of U.S. industries because it is so large. For example, EC public purchases reportedly account for 90 percent of U.S. telecommunications equipment sales in the EC and up to 33 percent of the sales by major U.S.

computer and office machine manufacturers. EC governments are also significant purchasers of data processing services and medical equipment. In some product areas, such as power generators and water treatment equipment, public utilities are among the most important potential EC customers for U.S. firms.

EC 1992 Proposed Changes in Public Procurement

In March 1987, the EC Commission put forward a reform package to improve the transparency of the tender/award process, to introduce competitive tendering in the GATT Code-excluded sectors, to open up procurement of services to a greater extent, and to tighten up enforcement. More attention was also given to helping small and medium-sized enterprises attain a share of the public procurement and construction business. As originally proposed, the measures would make major changes in EC public procurement procedures for supplies, public works, remedies, telecommunications, and energy, transport, and water.[1] The measures would cover both public and private companies, including post, telephone and telegraph companies, water companies, airports, maritime ports, railway companies, gas and electric utilities, and gas and oil explorers. By March 1, 1990, they would open procurement in the excluded sectors to intra-EC competition. U.S. government officials commented that the March 1, 1990, date may not be realistic, based on EC progress to date.

The EC Commission believes that the provisions of the Single European Act will also make progress toward opening up the public procurement and construction markets more likely. The act's research and development provision stresses the importance of public procurement, stating that to strengthen the scientific and technological base of European industry, the EC will support the cooperative efforts of firms to exploit the full potential of the EC internal market, particularly through opening national public contracts.

Unless the sectors currently excluded become covered by the GATT Procurement Code, as the U.S. government hopes will happen, the public procurement market will remain split under the EC Commission's proposed plan, due to the different bid requirements for the GATT Code-excluded sectors and Code-covered procurement areas. According to USTR, the EC Commission's current proposal provides that entities in the

[1]Supplies refers to the awarding of public supply contracts, and works refers to the awarding of public works contracts. Remedies refers to the formal complaint and enforcement mechanisms and redress in general and would apply only to contracts covered by the supplies and works measures.

excluded sectors would be permitted to continue to discriminate against suppliers of non-EC products—they may exclude from consideration offers containing less than 50-percent EC content. If they do consider bids with less than 50-percent EC content, they must grant a 3-percent price preference to equivalent offers containing at least 50-percent EC content. In this way, procurement in the excluded sectors is being completely opened only to suppliers of EC products.

An EC official told us that this proposal was influenced by the U.S. Buy American Act. The EC has indicated that the 50-percent content requirement, unlike that of the Buy American Act, will be based on the value of both goods and services in the contract, including research and development. One U.S. business association believes that this policy could pressure companies to increase foreign research and development in the EC to meet such a content requirement. EC officials have also said that there may be differences between contract price and contract value. Liberalization of EC government procurement in the excluded sectors is of particular interest to the U.S. telecommunications and heavy electrical equipment industries. Because sales to EC governments in the heavy electrical equipment sector are currently close to zero, U.S. officials view any new market opportunity as a positive step. However, according to congressional testimony by the heavy electrical equipment industry, meeting the EC content requirement would necessitate substantial financial investment in Europe. Because the majority of these manufacturers are small businesses, few have the resources to open a European plant. Thus, U.S. government and industry officials agree that the EC measure, as it applies to heavy electrical equipment, is unlikely to increase sales of U.S. heavy electrical equipment to EC government entities in the near future. According to Commerce, U.S. telecommunications industry officials are concerned that the 3-percent price preference for products and services applied in conjunction with EC content rules may restrict the sales of telecommunications equipment in the EC.

It appears that, without code coverage of these currently excluded sectors to gain nondiscriminatory bidding opportunities in these sectors, U.S. businesses will have to increase the value of EC parts, labor, and services in their production. The EC content requirements create an incentive for the growth of U.S. investment, joint ventures, and licensing agreements in the EC. There is debate, however, as to whether U.S. investment will come as a result of economic opportunity or as a result of fear of exclusion from the EC market.

U.S. suppliers in the excluded sectors are also apprehensive about how EC content will be calculated and whether the 50-percent threshold might be raised. Reportedly, efforts are being made to raise the proposed content level to 60 percent and to increase the EC price preference to 10 percent. However, according to a State Department official, other efforts are being made to delete the threshold altogether.

The proposed EC tendering procedures to open public procurement markets in the excluded sectors are similar to the GATT Government Procurement Code procedures. For example, all of the measures include rules, such as compulsory EC-wide advertising and objective criteria for disqualifying or eliminating bids, and prohibit discriminatory specifications.

Multilateral Public Procurement Negotiations

The GATT Government Procurement Code requires signatories to allow suppliers of products from other signatories to compete for government contracts in sectors covered by the code that meet specified criteria. It also establishes common and more transparent procedures for providing information on proposed purchases, open bids and awarding contracts, and settling disputes. The Committee that administers the code agreed in 1986 to (1) continue negotiations for increasing the number of agencies and procurements covered by the code, particularly in telecommunications and heavy electrical and transportation equipment, (2) work toward code coverage of service contracts, and (3) adopt a series of amendments to improve the functions of the code. The code amendments were approved on February 14, 1988. The negotiations on the other two items are scheduled to end in 1990.

Rules of origin comprise another area of GATT negotiation that will have important ramifications for public procurement. In the GATT Code, liberalization of government procurement has been negotiated on a reciprocal basis, that is, the right of competitive treatment is extended to those countries that have provided comparable rights in return, and discriminatory treatment is retained for products from countries that have not done so. A rule of origin is applied to determine which products are eligible for competitive treatment under code liberalization agreements. Unlike the customs rule of origin, procurement rules of origin are not administered at the border but are considered by procurement officials as a factor in evaluating supplier bids before contracts are awarded.

Some recent EC changes in public procurement implement EC commitments made in the context of the 1986 renegotiation of the code. In addition, the EC envisions a substantial strengthening of existing internal member state commitments on public procurement as part of the EC 1992 program.

A USTR official feels that the political momentum of the 1992 initiative gives the EC real prospects of gaining the needed authority to help push international negotiations forward. The United States seeks to reach agreement with the EC that all U.S. and EC products will be given reciprocal national treatment in public procurement. The USTR official told us that the United States would like to revise the GATT Government Procurement Code to require a standardized rule of origin and national treatment for any product that has been manufactured in a signatory country and contains at least 51-percent signatory content. Negotiations to expand the code stagnated for several years, primarily because the EC had no internal jurisdiction over the procurement markets of the member states in the excluded sectors; however, according to USTR, negotiations are currently nearing a decision.

Implications for U.S. Exporters

Because U.S. manufacturers in Europe would be able to bid on any contract covered by the EC measures, they would presumably benefit from the requirements for broader coverage and increased transparency; however, it is not clear how quickly the EC public procurement market will be liberalized.

U.S. exporters' seeking to sell their products in the EC public procurement market face uncertainty in both their production decisions and in market access. Because EC content rules are applied only to the excluded sectors, U.S. exporters' using U.S.-sourced components face production uncertainty. For example, a product purchased for use in an agricultural warehouse does not have to meet the EC content rules, but the same product purchased for use by a monopoly, such as a railway warehouse, must meet the EC content rules associated with public procurement. Producers must base production decisions on the market that they expect to serve. In the excluded sectors, market access for U.S. exporters is uncertain at this time.

A U.S. business association official wondered whether the new rules would be enforced for the former GATT Code-excluded sectors and whether transitional rules designed to open up the market gradually would apply to these sectors. He indicated that at this point no one

knows which sectors might implement transitional rules or how long these rules would apply.

U.S. exporters continue to find themselves in a totally unpredictable market access situation. According to a USTR official, U.S. exporters' bids in the excluded sectors may be thrown out at any point in the procurement process. While not as onerous as being mandatorily locked out of the EC market, this possibility prevents suppliers from making long-term plans based on predictions of how much of the market will be open. Suppliers may put their money and other resources into preparing bids that may never be seriously considered. In USTR's view, this situation is unlike the U.S. Buy American provisions in which foreign bids receive competitive consideration subject to predictable price preferences.

Conclusions

Opening the EC public sector markets to non-EC suppliers will ostensibly provide additional export opportunities for U.S. firms, but many questions surround the issue. What is certain is that most of the contracts covered by the proposed EC procurement measures are not currently covered by the GATT Code. Success in negotiations to expand coverage of the code could benefit the U.S. exporting community by removing this uncertainty and clarifying the application of EC content rules for public procurement.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.	William M. Freeman, Project Director Barbara Keller-Cohen, Project Manager Sara B. Denman, Evaluator
European Office	Jeffrey K. Harris, Evaluator

Requests for copies of GAO reports should be sent to:

U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are $2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.