The US-EU Trade and Investment Pact

On July 8, 2013, representatives for the United States and European Union met in Washington, DC to begin negotiating a transatlantic trade and investment partnership (TTIP). The accord envisioned by both sides is unprecedented in scope, aiming to remove tariffs as well as substantially reduce non-tariff barriers to trade between the world's two largest economic spaces. Achieving such an ambitious goal requires overcoming significant obstacles: numerous serious stumbling blocks stand between negotiators and completion of a pact ahead of the stated 2015 deadline.

This brief analyzes the rationale for, promised benefits of, and potential barriers to completion of a TTIP accord. It is structured as follows: the first section examines the current state of transatlantic trade and investment links, noting their large but shrinking share of global economic trade and investment activity. The second section then looks at the scope of the hoped-for agreement and quantifies its anticipated impact. The third section highlights the problems likely to trip up negotiations while the fourth section concludes by setting expectations for the negotiations as they move toward a second round of talks in October 2013.

The Current State of Transatlantic Trade and Investment Links

While the United States and Europe remain the largest players in the global trading system, their dominance has eroded in recent years. The EU and US together account for roughly 45 percent of global output and 30 percent of global trade. The most significant dynamic in the transatlantic trading relationship is how much the two sides of the Atlantic rely on each other as export markets: outside of NAFTA and internal EU trade, the US and EU export more goods and services to each other than to any other country.[1]

Trade only constitutes one small part of the wider US-EU economic relationship. In terms of global share, transatlantic investment links are far more significant. At the start of 2012, the United States and EU accounted for over 65 percent of the globe's stock of foreign direct investment (FDI). [2] Much of this investment flows back and forth rather than to third parties: roughly 30 percent of European investments abroad are in the United States, while nearly 40 percent of FDI into Europe originated in North America.[3]

FDI is only part of the wider picture. Reciprocal portfolio investment also forms a crucial transatlantic economic artery, as does the operation of foreign affiliates: the sales of European firms in the United States and American firms in Europe are 400-500 percent more valuable than all transatlantic trade taken together, generating over $1 trillion in

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combined output and creating over seven million jobs.[4] These links feed back into trade: much of the transatlantic trade in goods takes place inside firms.

The major change over the past decade has been the rise of emerging economies – particularly China. China has grown as an alternative producer of imports into the US and EU, as an increasingly sought after market for exported goods, and as an alternative destination for foreign direct investment. China became the EU's largest source of imports in 2007 and America's in 2009.[5] Though the stock of inward investment remains small relative to the US and Europe, China surpassed the United States as the world's largest recipient of *new* inward FDI in early 2012.[6]

The rise of China and the other emerging economies have caused an erosion of the traditional North Atlantic domination of global trade and investment flows. The share of economic activity accounted for by the US and Europe has declined markedly from just a decade ago, when the transatlantic partners accounted for roughly half of all imports, 40 percent of all exports, and the vast majority of all cross-border investment activity.[7]

TTIP's Potential Impact

Trade between the United States and Europe is conducted at tariff rates determined by the two sides' World Trade Organization (WTO) "most-favored nation" (MFN) status. These tariffs are generally quite low. For instance, the average MFN tariff for goods entering the United States is 3.5 percent while the average in the EU is 5.2 percent. However, these low overall numbers mask relatively high levels of protection in certain sensitive sectors: the MFN duties on dairy products entering the EU are over 50 percent while overall average on agricultural imports is nearly 14 percent. Likewise in the United States, leather goods, textiles, and clothing are all subject to tariff levels over 30 percent.[8]

An EU consultation with industry groups found that 45 percent of respondents reported that tariffs encumbered their businesses. Much of the objection came from firms facing higher production costs due to tariffs on goods flowing through intra-firm but transatlantic supply chains. A European Commission report estimated that the impact of a substantial reduction of tariffs alone would be enough to increase US bilateral exports by 12 percent overall, leading to an increase in output of 0.04 percent of GDP each year. Europe would receive a smaller bump to bilateral trade – just over 6.5 percent – but would see a larger 0.1 percent boost to annual GDP.[9] These gains are ultimately quite small. Consequently, while lowering tariffs may arguably be the easiest task facing TTIP negotiators due to the already relatively-free trade across the Atlantic, the gains on offer are quite modest.

In order to be considered a success, the eventual agreement must be far more comprehensive. The more difficult task is to dismantle the proliferation of non-tariff barriers to transatlantic trade and investment. During the EU's public consultations phase prior to negotiations, it was regulatory barriers rather than tariffs or customs procedures, that were cited as the largest barrier to transatlantic business. Likewise, American

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agricultural, pharmaceutical, and technology firms have raised concerns over regulatory divergence between the United States and Europe.[10]

The fully comprehensive TTIP envisioned by the US government and European Commission would harmonize safety and environmental standards, increase the mutual recognition of professional licenses and supplier certifications, and ultimately foster convergence on a single set of regulatory norms in a variety of fields. It would entail creating a mechanism for bilateral consultation on regulatory measures before those measures are implemented rather than forcing the partners to deal with them after they enter law. Moreover, the European side is keen to see liberalization in government procurement and the transportation industry included in any agreement.

The Centre for European Policy Research (CEPR) estimates that a fully comprehensive agreement covering these issue areas would result in an additional €68-119 billion in European economic activity each year as well as an output boost of between €49 and €95 billion in the United States (depending on the scope of the final agreement). The overall growth impact of a comprehensive accord would be four to ten times larger than simply a lowering of tariffs. In a practical sense, the impact could be as much as €545 in extra disposable income for a European family of four and €655 for their American counterparts.[11]

Potential Stumbling Blocks

The costs and benefits are not evenly distributed, however. Precisely which sectors will gain and which lose leads to a discussion of where potential obstacles lie.

These difficulties focus on four areas: the harmonization of product standards, the licensing of professional services providers, the reconciliation of divided competencies between American state and federal bodies as well as between the European member states and EU, and the continued existence of explicitly protectionist measures in the American transportation sector. In each of these cases, there are specific groups, industries, or firms which would explicitly gain (or lose) through the liberalization of transatlantic trade and investment.

The first and most diverse group of potential problems concern on the problem of setting and mutually recognized regulatory standards. Generally speaking, American and European product standards are set very differently, resulting in additional costs for firms wishing to export their products across the Atlantic in either direction. One major difference is in voluntary product certifications (i.e., standardized statements of product quality). In the United States, product certification is typically done through self-certification or certification by competing third-parties (some of which are themselves profit-seeking companies). This effectively results in selective voluntary certification of products which allows businesses to choose the method of certification which suits them best. Competing European firms countries, in contrast, typically have voluntary but unified certification processes which are administered through national governments.[12]

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Standard-setting is particularly problematic in the market for automotive products. Unlike voluntary certification for consumer products, the EU and United States each maintain national regimes for the automotive safety certification. The European system is based on the 1958 standards laid out by the United Nations Economic Commission for Europe while the American system is its own Federal Motor Vehicle Safety Standards. This means that firms looking to export their cars must incur the cost of meeting a separate set of requirements. This has been estimated as approximating a tariff of over 25 percent for European firms looking to export into the United States.[13] By eliminating this form of *de facto* protection, European automotive firms – which export nearly five times the automobiles to US as American firms export to Europe – stand to be among the biggest winners of an agreement.[14] Their American competitors would accordingly be among the biggest losers.

On the American side, the US agricultural sector has long chafed at European limits or outright bans on animal products treated with hormones as well as genetically modified crops, leading to an acrimonious dispute settlement procedure through the World Trade Organization. That ended in 2006 with a 2006 ruling against many of the EU's restrictions; yet even so, approval of American genetically modified crops like soybeans continues to be slow.[15] On the American side, agricultural exporters would gain (and European agricultural producers would lose) from the conclusion of an accord which mitigated Europe's historically protectionist approach to its farming industry.

Large technology firms such as Facebook and Google have also struggled with stringent European data protection and privacy rules. Privacy rules have limited those firms' expansion in areas such as providing "cloud" data storage. While a TTIP agreement that weakens those rules would greatly benefit Facebook and Google, international advocacy groups for digital freedom and Internet privacy have argued that it might lead to a corrosion of the EU's relatively strong consumer protections in the interests of achieving a wider deal.[16]

A second major obstacle for negotiators are differing rules for the recognition of qualifications in professional services fields. For instance, an accountant, engineer, lawyer, or doctor qualified in the United States may be unable to work in Europe without earning a new local qualification – and vice versa. This hampers the international liberalization in the trade of professional services by sometimes impossibly high retraining costs which might otherwise be unnecessary.

A third challenge – arguably the most difficult to overcome – concerns the problem of divided competencies in both the United States in Europe. In the US, some rules apply at the federal level, some at the state level, and some at both. The issue is similar in Europe, where the EU and its member states have divvied up responsibility for oversight of different policy areas.

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For European exporters, this can create a barrier to entry into any market where regulations differ from state to state. For instance, European insurance firms – which export more than €5 billion in services to the United States – face a different regulatory regime in each state, raising costs and effectively protecting local competition. In fact, other than automotive firms and water utilities, European insurers would be the largest European victors of a free trade agreement.

Competency issues also play in one of the Europeans' biggest complaints about American trade policy: the continued use of preferential treatment for American firms in government procurement. The US federal government is bound by the 1995 WTO agreement guaranteeing free international competition for government contracts. However, 13 state governments as well as all municipal governments lie outside that agreement – and many continue to maintain "buy American" provisions which bar European firms from competing with their American counterparts.[17]

A similar complaint has been leveled at Europe by the US side: even after the EU agreed to allow further genetically modified products into the European market, some member states continued to block them.[18] Furthermore, American entertainment firms have been antagonized by loose rules toward intellectual property and privacy in certain European jurisdictions.[19] Likewise, certain countries maintain idiosyncratic protections for sectors seen as sensitive: for instance, in the run-up to the first round of talks in July 2013, France cast a pall over the negotiations by insisting that it be allowed to maintain protections for the domestic film and television sector.[20]

The fourth stumbling block to an accord is the fact that the United States continues to maintain explicitly protectionist measures in the air and maritime transport industries. Foreign firms are barred from owning more than 25 percent of American airlines, cannot provide air connections between American cities, and are completely barred from shipping goods between US maritime ports – an anachronism dating to the 1920 Jones act. In each of these areas, the EU has relatively liberal rules in place.[21]

Outlook

Both the US and the EU agree on the need to aim for a comprehensive accord: the potential gains of a discussion limited to tariffs a simply too limited. The 150 delegates who gathered in Washington in July 2013 were consequently grouped into two dozen working groups tasked with working on 20 topics. The stated goal of the project is to conclude negotiations "on one tank of gas," taken to mean the before the next European elections at the end of 2014.

This is likely to be overly optimistic. The biggest obstacle to the completion of such an ambitious accord is not a single issue but the sheer number of potential problems and the subtleties involved in dealing with them rapidly. Each of the barriers to an agreement promises its own difficulties:

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Harmonizing standards set at the federal and EU level will require reconciling powerful industries playing seemingly zero-sum games. The powerful agricultural, automotive, and transportation lobbies of Europe will be pitted against their counterparts in the United States. Likewise, the American technology and entertainment industries will be working against European consumer advocates. Negotiators will be under pressure from these groups and their allies in power. Even so, while these issues are likely to cause tension in the negotiations, they were widely known before discussions started. The talks would not have begun at all if the parties believed them to be insurmountable.

The trickier problems involve lesser-known challenges, such as finding a way to iron out the differences between decentralized voluntary product certification in the United States and the more centralized model practiced in Europe. Professional qualifications recognition will be similarly difficult: despite years of work and multiple EU directives on the subject, there are still unresolved problems in intra-EU qualifications recognition – and some areas in which qualifications continue to differ across American state lines.

The biggest danger of all lies in the divided competencies on the part of both the Americans and Europeans. For the Americans, the challenge will be to make any commitment which requires the action or approval of state and local governments. Local opposition to federal attempts to impose a centralized set of rules is likely to be fierce. There will also be squabbles between the federal branches of government: while the negotiations are carried out by the executive branch, ratification will ultimately require the approval of the perpetually gridlocked US Congress. The fact that a comprehensive accord will require changes to long-standing laws (such as the Jones Act) will further involve Congress.

Similar problems lurk for Europe. While some issues (such as tariffs) are clearly the responsibility of the EU itself, other competency issues are more complex. Environmental and cultural issues, in particular, are still decided at the member state level. While the EU currently has a mandate to negotiate on behalf of member states, it is all but certain that the final agreement will cover areas of mixed competencies. This creates a hurdle near the finish line: the final accord is likely to require ratification by the member states as well as the European Council. This was not a problem for the mixed-competency EU-South Korea free trade agreement; however, TTIP is almost certain to be more politically sensitive. France's demand to remove film and television rights from the EU's mandate for negotiation – while almost certainly intended for the domestic audience – is an early warning sign that mixed competency issues are likely to be significant.

With all the difficulties noted here, there is little hope of reaching a comprehensive agreement in the next 18 months. Moreover, the longer the negotiations drag on, the more endangered they will become: 2015 will see the inauguration of a new European Parliament and Commission – a new group of leaders which would not be politically committed to the present talks. Likewise, the next American presidential election will effectively begin toward the end of 2015, introducing a new distraction to the already-moribund American political system. It would be difficult to imagine, for instance, an

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agreement which harms the US auto industry becoming law during an election year. This dynamic is ultimately likely to favor either slow and quiet breakdown of talks or the relatively rapid conclusion of a limited accord.

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[1] European Commission and World Bank figures
[2] Organisation for Economic Cooperation and Development (OECD) and authors' calculations from OECD international direct investment database, Eurostat, International Monetary Fund (IMF) and BEA data.
[3] OECD international direct investment database.
[4] Daniel Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2012: Annual Survey of Jobs, Trade, and Investment Between the United States and Europe* (Center for Transatlantic Relations, Johns Hopkins University's Paul H. Nitze School of Advanced International Studies, 2012). US BEA foreign affiliate data.
[5] Eurostat [bop_q_eu] and US Bureau of Economic Analysis (BEA). Data excludes intra-EU trade.
[6] OECD international direct investment database.
[7] Ibid; Eurostat [ext_lt_introle]. Data excludes intra-EU trade
[8] WTO Country Profiles (2011 data)
[9] European Commission, *Impact Assessment Report on the Future of EU-US Trade Relations*, March 12, 2013, http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150759.pdf.
[10] Ibid.; Doug Palmer, "After Long Buildup, U.S.-EU Free Trade Talks Finally Begin," *Reuters*, July 8, 2013, http://www.reuters.com/article/2013/07/08/usa-eu-trade-idUSL2N0F71XS20130708.
[11] *Reducing Transatlantic Barriers to Trade and Investment An Economic Assessment* (Centre for Economic Policy Research, March 2013), http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150737.pdf.
[12] European Commission, *Impact Assessment Report on the Future of EU-US Trade Relations*.
[13] Koen G. Berden et al., *Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis* (Ecorys, December 11, 2009), http://trade.ec.europa.eu/doclib/docs/2009/december/tradoc_145613.pdf.
[14] EU DG Trade statistics
[15] Philip Brasher, "GMO Soybeans Are Speed Bump in EU Trade Deal," *Roll Call*, July 26, 2013, http://www.rollcall.com/news/gmo_soybeans_are_speed_bump_in_eu_trade_deal-226678-1.html.
[16] Center for Digital Democracy, *Comments of the Center for Digital Democracy on the Transatlantic Trade and Investment Partnership* (Center for Digital Democracy, May 10, 2013), http://www.centerfordigitaldemocracy.org/sites/default/files/CDDUSTRMay102013.pdf.
[17] European Commission, *Impact Assessment Report on the Future of EU-US Trade Relations*.
[18] Ibid.
[19] Charles Arthur, "ACTA Set to Fail After Europe's Trade Committee Votes Against It," *The Guardian*, June 21, 2012, http://www.guardian.co.uk/technology/2012/jun/21/acta-europe-vote-against.
[20] Robin Emmott, "EU Offers to Give France Bigger Say in U.S. Trade Talks," *Reuters*, June 13, 2013, http://www.reuters.com/article/2013/06/13/us-eu-us-trade-idUSBRE95C0XD20130613.
[21] European Commission, *Impact Assessment Report on the Future of EU-US Trade Relations*.

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