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TOWARDS A TRANSATLANTIC MARKET

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SUMMARY

A new transatlantic momentum has been set in motion by the economic crisis. Both the US and the EU need every impulse for growth they can find. Their effort can also help to create a single global market based on regulatory convergence, equality of rights and responsibilities, and a level-playing field. The success of TAFTA, the new trade and investment agreement which is being launched, is necessary if the US and the EU want to take advantage of their predominant role in the international economic system. In parallel, the EU and the US need to better understand each other's macroeconomic policies with a view to improved coordination which is required by their structural interdependence. Finally, the jury is still out on whether the EU and the US can come to a joint understanding on issues of energy and climate change. Research collaboration on new technologies can help to bridge the existing policy gap.

This Policy Paper is part of a series entitled "Promoting EU economic interests abroad" which also includes contributions by Richard Youngs (FRIDE) and John Springford (CER), Jonas Parello-Plesner (ECFR) and Agatha Kratz (for ECFR), Daniela Schwarzer (SWP), Federico Steinberg (Real Instituto Elcano) and Diego Valiante (CEPS), Dimitrios Katsikas (Eliamep), Filippa Chatzistavrou (Eliamed) and Yiannis Tirkides (CCEIA).

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Carnegie Europe, CCEIA, CER, CEPS, demosEUROPA, ECFR, EGMONT, EPC, Real Instituto Elcano,
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Four other series of Policy Papers deal with key challenges on defence, EU neighbourhood, strategic resources and migration. The final report presenting the key recommendations of the think tanks will be published in March 2013, under the direction of Elvire Fabry (*Notre Europe – Jacques Delors Institute*, Paris).

Introduction

The transatlantic economic agenda has been shaped in recent years by the economic crisis and the interaction of different strategies pursued by the US and the EU in an effort to overcome it. Much of the debate has addressed the main sources of instability, particularly in the context of the eurozone crisis. There is now an opportunity to break through the growing wall of distrust with a major initiative to advance the transatlantic trade and investment agenda.

That project has been on the back burner in recent years for a number of reasons. Efforts to revive the Doha round of multilateral trade talks played a role in the early period. A potential global agreement was prioritised to bilateral arrangements. The EU was closely attached to the objective of effective multilateralism. In the meantime, however, the balance of power in the WTO tilted towards smaller and less developed countries, making any breakthrough agreement difficult. Conclusions had to be drawn. As a result, in recent years the EU has focused on bilateral trade agreements with other partners such as South Korea, India, Singapore and Canada, while the Obama administration has been on the defensive in its trade policy, continuing earlier initiatives without floating new ones.

1. Getting the most out of the crisis

Economic slowdown has helped refocus attention on the benefits of a new transatlantic trade and investment agreement. Michael Froman, a senior official in the White House, has spoken of the need to have it completed "on one tank of gas". At least part of the reason is that exports have been a powerful driver of growth in the US economy. They account for almost half of US growth in during the recovery period, much more than the average 12% in previous economic cycles. The Brookings' "Export Nation 2012" report found that manufacturing was responsible for three-quarters of additional sales abroad between 2009 and 2010. Last year, the EU imported a massive US$ 243.5 billion in US goods.[1]

In spite of the crisis, Europe provides a more attractive type of demand than emerging economies, whose growing middle classes will continue to want basic consumer goods throughout the next decade. The EU and the US remain each other's most important trade and investment partners. Over US$600 billion is traded between the EU and the US each year – about one-third of global trade – while US$1.9 trillion is invested by the US in the EU and US$1.5 trillion by the EU in the US (2010 figures).

"US AMBASSADORS WORLDWIDE HAVE BEEN INSTRUCTED TO SHIFT THEIR FOCUS TO ECONOMIC STATECRAFT"

The American government has moved to assertively promote American exporters' prospects. US ambassadors around the world have been instructed to shift their focus to economic statecraft. Trade policy, however, has remained fairly static. No new initiative was launched during President Obama's first term in office. He has had to renegotiate deals with South Korea, Panama and Columbia, agreed under George W. Bush, in order to appease the auto industry and labour unions. The Transpacific Partnership, Washington's flagship project, has absorbed US policymakers but is not near completion. The domestic political consensus has become anti-trade.

1. US Census Bureau figure.

2. The promise of a Transatlantic Free Trade Area (TAFTA)

This means that an agreement with the EU could be an opportunity for President Obama to kick-start his trade policy as debate in the US cools down, not only with the end of the electoral season but also with China's shrinking current account surplus and independent analysis of the undervaluation of the renminbi. The latter showed that the beast is not as ugly as it has often been portrayed. Political frictions will continue and Obama is not likely to be granted the fast-track Trade Promotion Authority from the Congress which Mr Romney would have won. However, the Republican-dominated House will be easier for Mr Obama to deal with given the suspicions on trade issues among the Democrats.

In Europe, just as 2012 was a year of stabilisation, 2013 will be about an intensive search for new sources of growth. The potential deal with the US features highly on that list. There is no reason to doubt EU leaders' commitment. Chancellor Merkel made it the cornerstone of her 2007 EU presidency. That attempt faltered as the crisis unfolded but the determination remains strong. In the meantime, the EU has had a very good run on trade policy. Even though it is a complex and slow-moving organisation, it has concluded a free trade agreement with South Korea and got it ratified faster than the US has been able to proceed with a similar package. It has also sealed a deal with Singapore and is close to the final accords in talks with Canada. It is the latter which clearly has a lot of impact on the thinking of US policymakers. The North American Free Trade Agreement (NAFTA) has shaped the American economy more than any other external factor. Canada is now one of the top destinations for US exports. If the EU concludes a free trade agreement with Canada, it arrives in Washington's backyard.

The EU has traditionally been in a better position when it comes to its trade balance: it stood at a surplus of nearly US$100 billion in 2011. The surplus fell with the onset of the economic crisis in 2007-2008 but has grown again since 2010. Foreign Direct Investment (FDI) flows from the EU to China are consistently growing but, at €75 billion, are nowhere near the level of European investment in the United States. The scale of that transatlantic relationship dwarfs any other in the world. The EU imports three times more goods from the US (US$286.1 billion in 2011) than China but exports twice as much as it does to China (US$368 billion in 2011). It is also a balanced relationship in which the US runs a deficit in goods, a surplus in services and FDI flows are similar in size. About 15 million jobs have been created as a result, on both sides of the Atlantic.

Mutual benefits from a new comprehensive trade agreement are clear. The US Chamber of Commerce estimates that lowering remaining tariffs on goods from the current level of 5-7% to zero would increase transatlantic trade by more than US$120 billion within five years with a related increase in GDP of about US$180 billion. Eliminating tariffs would make US and EU companies more competitive, especially as more than one third of them are affiliates of the same companies. Removing regulatory barriers would also offer substantial gains, increasing EU GDP by 0.7% and US GDP by 0.3%, according to a study by ECORYS commissioned by the European Commission. Where Europe is concerned, the transatlantic deal could lead to the introduction of more flexibility into economic, investment and labour policies on the continent, helping the process of structural change.

> **"THE TRANSATLANTIC DEAL COULD LEAD TO INTRODUCE MORE FLEXIBILITY INTO EUROPEAN ECONOMIC, INVESTMENT AND LABOUR POLICIES"**

Mutual sensitivities over issues such as EU restrictions on genetically modified organisms or US laws on airline ownership remain. They have sunk past attempts at free trade deals while new disagreements have emerged in areas such as internet privacy. Not everyone will be happy. The National Pork Producers' Council, for one, has already written to the US trade representative to express concern. The negotiations will be arduous and the list of issues to be covered is enormous, from service liberalisation and regulatory differences, to intellectual property and public procurement. Some early decisions will be of systemic importance. They include the choice of whether harmonisation or mutual recognition should be pursued in the regulatory context.

The prospects for the EU-US trade deal will benefit from the fact that both economies are relatively aligned on social, labour and environmental standards, especially compared to other bilateral relationships. In the US, in an unprecedented move, trade unions and the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) have come out in favour of the talks being launched. American people support closer trade ties with Europe – 58% have backed the idea (28% were against) in a 2010 Pew opinion poll. The deal may help demystify trade in the domestic US debate. It could also be an opportunity for President Obama to improve his relationship with businesses.

It remains to be confirmed within the political context whether negotiations should be comprehensive in character, spanning all policy areas or selective, hoping to generate momentum on a case-by-case basis. The former would be far more ambitious. It would, however, make the whole exercise vulnerable to single issues or interest groups, thus slowing the momentum of the process. Apart from being mutually beneficial, the EU-US trade agreement would have the added advantage of setting the standard for future trade negotiations with emerging countries on regulation, tariffs and investment rules.

3. Strategising economic dialogue

Apart from pursuing an aggressive trade and investment agenda, the transatlantic relationship will need to extricate itself from the fallout of the financial and economic crisis. The latter increased EU-US tensions after an initial period of smooth cooperation. In late 2012 and early 2013, governance in the EU and US converged with crisis legitimacy playing a big role on both sides of the Atlantic and brinkmanship being practiced with growing ease. As Thomas Kleine-Brockhoff has rightly observed, the US has europeanised its crisis response through the recourse to cliffs and deadlines and not seeking a comprehensive solution.

This may make it more likely for the EU and the US to agree to a regular strategic economic dialogue in order to better understand each other's perspectives on mutual challenges and more effectively coordinate macroeconomic policies. Such a dialogue is necessitated by the structural interdependence of the transatlantic economy, where sovereign debt issues or current account imbalances create problems which rapidly spread to the other side of the Atlantic. Annual strategic economic dialogue could involve officials from the Federal Reserve, the ECB, the US Treasury, finance ministers from European Union Member States and relevant officials from the European Union. A regular peer review could be conducted of economic assumptions on both sides of the Atlantic, structural impediments to growth, policy goals and actions. It would also facilitate eventual transatlantic market integration.

4. Bridging the gap on energy and climate change

Some sectoral challenges have grown to become agenda items in their own right. Other important areas of dialogue include energy and climate change, as the US shale gas and oil revolution has changed the country's position entirely. The US is not far from becoming self-sufficient when it comes to its energy needs. It is likely to become an exporter of liquefied natural gas (LNG) which recent NERA studies have shown make economic sense. Furthermore, the US is expected to become the world's largest producer of oil and LNG. The EU is nowhere near improving its energy position in similar terms, having pinned its hopes on the growth of the renewables' sector where no revolution comparable to that of shale gas has been forthcoming. However, the EU has benefited from developments in the US which have had a powerful impact on the world gas prices. That process is expected to continue if the US begins exporting LNG.

"A REWARDING APPROACH COULD FOCUS ON RESEARCH COLLABORATION IN MAJOR TECHNOLOGIES ACCROSS THE ENERGY MIX"

The second term of President Obama holds the promise of a renewed effort at EU-US consensus on climate change. The EU has remained faithful to its emissions trading scheme, even though the jury is still out as to whether appropriate carbon pricing in fact influences investor decisions. The US is unlikely to adopt cap-and-trade legislation and will rely on tax incentives and regulatory changes implemented by the Environmental Protection Agency. However, largely as a result of its switch to gas, the US achieved a 9% reduction in emissions between 2007 and 2011 – more than the EU recorded in the same period. One potentially rewarding approach focuses on research collaboration in major technologies across the energy mix. Creating a Transatlantic Innovation and Research Space and a joint EU-US Research Council with programmes in the field of energy would greatly help to bring new technologies to the market.

5. Towards a world of norms

The final issue of enormous significance for the future world order, including the role played by the transatlantic relationship, has to do with efforts to strengthen the normative framework for the international economic system. The closer the transatlantic community stays together on these issues, the more likely emerging powers will feel inclined to become responsible stakeholders in the system.

The flip side of the coin must be a level playing field. Assurances are necessary that in a more competitive environment countries will play by the rules and not attempt to bend them to their advantage. The multilateral process has been focused on the removal of tariff barriers to trade and it has not found sufficiently workable means to address non-tariff barriers, including protectionist regulations, mandatory technology transfers, sub-market subsidies or unfair joint venture requirements. International institutions and processes are currently not in a position to address these new types of barriers. In parallel, state capitalism is bearing heavily on the global playing field, given the advantages that state-owned and state-controlled enterprises tend to enjoy, including preferential funding arrangements and protection from competition.

Both the US and the EU are becoming increasingly active in fighting such abuses, whether in the form of illegal subsidies, forced technology transfers or violations of intellectual property rights. The level of their commitment to that process will become a crucial litmus test of their ability to work together in the multipolar world. Both the EU and the United States will need to actively elaborate policies to address these issues, examining the way in which the OECD-inspired principle of "competitive neutrality" can be made operational in the international environment. From a wider international perspective, the single transatlantic rule book will be a manifesto of faith in the liberal economic order.

6. Recommendations – The best opportunity in a decade for the transatlantic economic project

Parallels to an "economic NATO" have been drawn to reflect both the depth of a potential new transatlantic agreement which is expected to cover comprehensively trade in goods, services, investment and agriculture, and the powerful impact it would have on the outside world. The dynamic is indeed growing but it will require a lot of perseverance. The EU and the US have been down this path before. This time must be different.

Momentum should be built by seeking early agreement on the least sensitive part of the agenda while identifying, right from the start, elements which will require bigger bargaining within the most important dossiers. **The current agreement needs to be comprehensive in nature if it is to have a ground-breaking character**. Parties will have to move away from their pre-determined positions in order for a compromise to be found. This can be helped by engaging the opinion of independent experts and opening up extensive public debate on the substance of the agreement throughout the process of negotiation.

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