Danuta Hübner
Chair of the Committee on Regional Development

"The Transatlantic Trade and Investment Partnership"

Article for the website, 25 February
Strasbourg

The EU and the US are in midst of carving a historical trade agreement, a transatlantic trade and investment partnership (TTIP), which promises unprecedented gains in jobs and growth on both sides of the Atlantic. With the third round of negotiations on the TTIP recently completed, this article looks into the nature of the deal envisaged, its timing and importance, as well as into a number of outstanding issues, which may still complicate negotiations.

Discussions on the TTIP received a green light in February 2013, when transatlantic leaders announced they would start negotiations on a comprehensive agreement, which would cover mutual direct investment, open services and goods markets and address non-tariff and regulatory barriers.

The promises of the TTIP are by no scale modest. The agreement is expected to be the cheapest stimulus currently available, a deficit-free boost for growth on both sides of the Atlantic. Concrete gains of up to 0.5% of GDP are expected in Europe and 0.4% in the US by 2027.

The deal is meant to increase product variety, lower trading costs and thus lead to lower consumer prices. It promises to also benefit specific actors in the EU. One such group is that of export-oriented SMEs, which would be able to more easily operate also in the US following improved market access conditions and would no longer need to go through a complex process of double approval. The TTIP would also be particularly beneficial to catching-up CEE economies, for whom new technology and know-how coming from the US, an increase in capital flows, more R&D investments and improvements in infrastructure would make important contributions to economic growth. At the global scale, the deal could give an impetus to deadlocked multilateral trade negotiations and provide a blueprint for future bilateral trade deals.

While the decision to carve a comprehensive trade deal was born in February 2013, attempts at transatlantic trade cooperation are not new. Efforts have been on-going for more than two decades, with discussions however often fragmented over sectoral issues and political will often lacking. Knowledge gaps in newer regulatory domains and difficulties in mutual understanding further complicated matters. Tariff barriers in agriculture proved to be difficult sticking points. Food safety and environmental standards led to limited success on regulatory convergence.

Trade issues were addressed during the 1995 New Transatlantic Agenda, which aimed to strengthen bilateral economic relations. They were also an integral part of the Transatlantic Economic Council established in 2007 and its offspring, the High Level Group on Jobs and Growth set up in 2011. The High Level Group concluded in June 2012 that the greatest lever for jobs and growth would be a comprehensive transatlantic trade and investment agreement. EU and US leaders then gave the green light for the start of negotiations for such an agreement in February 2013.

Why, if attempts towards trade cooperation have faltered in the past, should it be different this time around?

One factor stimulating a timely completion of a comprehensive trade deal is the low-growth environment plaguing both the US and the EU. Another is the limited success, or even lack thereof, in multi-lateral trade rounds (such as Doha). Along with it comes the hope that a US-EU trade deal would give a new leash of life to trade cooperation. Beyond these two factors, comes also the changing global world with its added pressure. With emerging markets gaining weight on the world economic stage, the TTIP is also seen as an opportunity to reinvigorate the transatlantic relation and reassert its role on the global scene. The deal would thus help the EU and US regain some of the competitiveness lost relative to China or India.

A closer trade relation is in the interest of both transatlantic partners. The EU and the US still share a considerable part of the world economy and are mutually important from an economic perspective. On a daily basis, 1.3billion EUR worth of goods and services cross the Atlantic, amounting to one third of total global goods trade and 40% of services trade. The transatlantic economy creates up to 4.1trillion EUR in commercial sales each year and provides more than 15 million jobs. US and EU economic activity accounts for 5% of world GDP and for 41% of purchasing power.

Admittedly, as shown by the numbers, transatlantic trade is already significant. Tariffs are also already relatively low, recording on average between 3-4%. Exceptions also exist however, including tariffs in agriculture, textiles, apparel and footwear. So while the bulk of tariffs are low, the small share of remaining high barriers still bears the potential to lead to considerable gains, precisely due to the significant volume of EU-US trade.

Going beyond trade in goods, which accounts for 20% of transatlantic trade, services trade liberalisation promises to provide even more gains. Services account for more than 70% of US and EU GDP. Moreover, the transatlantic actors represent each other's main commercial partners and growth markets in terms of services trade and foreign direct investment.

Having said that, the bulk of the gains are expected to come from non-tariff barriers (NTBs), which promise to become the signature of the TTIP. While it is true that previous trade cooperation initiatives have also dealt with domestic regulation, they have looked at it only in a narrow, rather limited way. The ambitions for regulatory convergence are much higher today.

NTBs represent measures which amount to discriminatory regulatory barriers to market access. They are often in place in order to protect consumers, worker health or the environment, or to enforce minimum quality standards. While NTBs might not be directly related to cross-border activities, they indirectly impact trade and investment. NTBs can result in higher costs for firms when it comes to doing business, they can also restrict market access.

Market access is mostly limited due to traditional NTBs, such as import quotas. Costs on the other hand are most likely raised when exports are conditional on a reconfiguration of products. NTBs appear to be highest for food and beverage products. Financial services NTBs also rank highly.

NTBs constitute tricky elements of the negotiation process for a number of reasons. On the hand, it is difficult to measure them and no well-established methodology exists for estimating NTBs consistently across countries and sectors in a harmonized way. Moreover, while the gains from NTB elimination can be substantial, the effects of NTB removal are often seen only with a lag which can take anything between 10-20 years. Finally, removing NTBs is harder than reducing tariffs and removing all NTBs might require constitutional, legislative or technical changes.

Looking at the TTIP, sizeable gains are expected from a reduction in NTBs in goods, harmonisation of rules overseeing conformity and safety standards for food, medical devices, machinery and chemicals. For these substantial gains to materialize however, political challenges stemming from different institutional structures and political sensitivities, will need to be overcome. This will not be an easy task.

What may be some of the best ways to address NTBs in the context of the TTIP? Two traditional approaches include harmonization and mutual recognition.

Harmonization involves an alignment of regulations to a single best practice. This could be based on international standards from a standard-setting body, or involve some form of coordination among the trading partners.

Mutual recognition can be based on mutual recognition agreements, or on the acknowledgement of regulatory equivalence. Such agreements can approve testing and certification processes of other countries and deem them acceptable for allowing sale in the importing country. Equivalence can acknowledge that different technical regulations can still achieve the same objectives.

Additionally, regulatory cooperation councils (RCCs) can also help lower NTBs. Such councils involve a pragmatic approach to dealing with regulatory divergence and involve also a regular input from private interests. While RCCs do not bridge all regulatory divergences, they can help find practical solutions to resolvable problems in sectors which matter most for the trading relationship. One existing example is the US-Canada Regulatory Cooperation Council. The latter follows the principle that a non-legalistic way can help find modest solutions to specific regulatory divergence problems. This platform also enhanced the legitimacy of trade relations between the two partners, by putting the debate in the open and allowing stakeholders to voice their concerns. Karel de Gucht, the EU Commissioner for trade, has already voiced this idea in the context of the TTIP by proposing the creation of a new Regulatory Cooperation Council, which brings together the heads of the most important EU and US regulatory agencies. The council would be tasked with monitoring and implementing commitments already made and with considering new priorities for regulatory cooperation.

Negotiations up until now have also been characterized by an unprecedented dose of transparency. While respecting the confidentiality of the negotiations, the Commission has already, and will continue to reach out to trade associations, consumer organisations, industry as well as to other civil society representatives, to gauge their views on the TTIP.

Moreover, the Commission has also set up an advisory group of experts for the TTIP. Interests represented by this group include environmental, health, consumer and business sectors, with each sector given the chance to offer advice to the EU trade negotiators on the areas being negotiated.

The Commission's recent decision to consult the European public on provisions related to investor-to-state dispute settlement (ISDS) further reflects the Commission's desire to make negotiations as transparent as possible.

The ISDS relates to the fact that not every country enjoys a strong legal system which guarantees foreign investors that they will be protected. Scenarios in which governments expropriate investors could arise (via nationalisation for instance, or via the passing of laws which may render investments worthless). For such cases, ISDS provisions in investment agreements offer security for investors and make it possible for them to have compensation claims. Discussions on ISDS in the context of the TTIP aim to protect investments by EU-based companies in the US and the other way around. The recent Commission moves to consult stakeholders aim to make sure that European citizens can voice their concerns on the topic, fix loopholes in existing investment arrangements and make the system more transparent.

In the broader picture of the negotiations, the Commission is also keeping the European Parliament and the Council well informed. When the negotiations will come to an end, the final deal will need to be approved by the directly elected representative of the people, the European Parliament and, by the representative of Member States' governments, the Council.

While the TTIP certainly comes at the right time, with a generous dose of transparency and promises to make significant headway in the realm of NTBs reduction, many uncertainties still plague TTIP discussions and could lead to a slowdown in the pace of negotiations. They include unknowns linked to the inclusion of financial services and data issues into the deal, the more general concern over excluding issues from the negotiating table, worries over agricultural disagreements, as well as spillover effects onto third countries and potentially within the EU.

Financial services:

The issue of financial services has been widely discussed in the context of the TTIP, yet no conclusion has been reached on whether these services will be included in the final agreement.

There are certainly clear benefits to having financial services on the trade agenda. These include increased competition, product choice, a strengthening of consumer and investor protection on both sides of the Atlantic, and an improvement in prudential regulation.

Europe is more pro including financial services than the US side. The US reluctance is mostly explained in virtue of the fact they do not want to re-open the Dodd-Frank act or the Volcker rule. Some concerns come also due to provisions made by existing EU legislation. For instance, the EU has watered down a number of specifications made by the Basel III agreement in CRDIV (eg. while a key minimum common equity capital or leverage ratio is binding in the US, the latter is not binding in the EU).

A further worry, making financial services off-limits for the Americans, is the risk that in the midst of negotiations, a trade-off might be made between financial sector provisions and another trade topic, leading to concessions in financial services. The US wants to stir clear of such trade-offs.

If cooperation of some form is to be achieved nonetheless, then this will most likely involve some form of equivalence. The EU side has already outlined its vision of this cooperation. In an information non-paper drafted at the end of January, the Commission expresses its view on a cooperation on financial services which involves the joint and timely implementation of internationally-agreed standards for regulation and supervision, mutual consultations ahead of new financial measures with potential effects on the transatlantic relation, a joint analysis of current rules with a view to seeing whether they impose unnecessary trade barriers and research into whether the other jurisdiction's rule are equivalent in outcomes.

Data protection:

Data protection is another topic which suffers from the same ambiguity in treatment as financial services. A main sticking point which makes it difficult to envisage a common stance on the topic is given by on-going negotiations on both sides of the Atlantic on different data-protection packages. These legislations could in turn lead to conflicting legal regimes. Moreover, the PRISM scandal has further reduced the hopes for a successful transatlantic cooperation on data issues.

Excluding items from the negotiations

The financial services and data protection issues bring into focus a broader theme of the negotiations, namely whether it is wise to exclude items from the agenda at the outset.

Commissioner de Gucht cautioned early on against excluding items from the agenda, arguing that exclusions on the EU side would be met by new demands from the US side. Nonetheless, the EU has already said yes to the cultural exception and remains reluctant with regards to discussing data protection as part of the trade deal. We have also seen that the US has acted similarly, by showing itself reluctant to put financial services on the negotiating table.

Thus while both sides understand the risks of making exclusions early on during the talks, they also understand that some exemptions will be inevitable.

Agriculture

Interests still clash considerably when it comes to agriculture. They concern US worries about EU food-safety regulations which interfere with US exports. US farm interests are also keen on the EU abandoning its precautionary approach to risk management, adhering instead more strictly to sound science. US soybean and corn farmers are also concerned about the EU's slow approval of GM crops. Grounds for cooperation may be more limited here.

Hormone meat remains banned in the EU and existing EU laws will not be infringed for the sake of cooperation in the context of the TTIP.

Losses for third countries and within the EU:

While the bulk of research forecasting the effects of the TTIP clearly highlights considerable GDP gains for the EU and the US, more caution is warranted when considering potential TTIP effects on third countries, and even within the EU.

In theory, changing terms of trade between the EU and US can also impact the terms of trade of other countries. When tariffs are lowered, trade diversion and trade creation occur, due to relative as well as due to absolute changes in trading costs. Negative spillovers on third countries may thus arise.

Current macroeconomic studies indeed echo these concerns and reveal that countries such as Canada, Mexico and Turkey are likely to be negatively affected by the TTIP. Also particularly vulnerable is the situation of developing countries in Africa. Asian economies, with the exception of Japan, will also feel the negative effects of the agreement.

The sheer scope of the countries potentially adversely affected by the TTIP warrants a consideration of possible solutions. One option would be to include the traditional trading partners of the two major economies into the negotiations or give them an early opportunity to enter into similar agreements with the trading partners. To ensure that trading partners who are important to the US or the EU are kept in the loop, negotiations could promote a track II process which permits input from both the US's and EU's most deeply integrated partners.

Another option would be to provide compensation to the losers from the TTIP (using some of the welfare gains from the TTIP) as well as making some concessions in multilateral negotiations. This would be particularly necessary in the case of African economies.

Finally, the EU and US could adopt a mutual recognition policy which applies to third countries with flexible rules of origin.

Not only third countries may however be negatively impacted by the TTIP. Some adverse effects could also be felt in terms of intra-EU trade (these would still co-exist with a substantial growth of transatlantic trade). TTIP will affect intra-EU trade because trade within the EU is now barrier free, while trade with the US still faces NTBs and tariffs. The opening up of trade with the US will thus affect intra-European trade, which previously enjoyed a preferential status. More specifically, macroeconomic findings revealed that German trade with the GIIPS countries will fall after the TTIP is put in place. This is compensated however to some extent by an increase in trade between the GIIPS and the US, as well as between Germany and the US.

Potential intra-EU trade losses should not however obscure the clear wins that TTIP could bring along. Looking at the EU, in particular smaller countries, such as the Baltic states, are likely to record substantial gains. Also, countries with lower per capita income stand out as winners. The TTIP thus acts as a booster of convergence in Europe, increasing trade benefits for countries with lower per capita income, such as Romania, more than for those with higher incomes, such as Luxembourg. Ultimately, all EU member states benefit from trade liberalization, the extent to which they gain however depends on the real trade structure of individual countries, on their size and geographical position.

As talks move forwards over the coming months, negotiators will need to strive to overcome existing bottlenecks and try to find common ground on topics over which differences remain. Divergences should not stand in the way of a vital stimulus, which both the US and the EU so urgently need.

Policymakers will also have to bear in mind the fact that the window of opportunity for reaching a deal is relatively small, extending from now until mid-2015, as the US nears its 2016 presidential elections. Negotiators will need to be efficient and through at the same time.

Bibliography

- Barker, Tyson; 2013; 'An early geo-economic conundrum for the US-EU trade deal;' Bertelsmann Stiftung

- Cardoso, Daniel; Mthembu, Philani; Venhaus, Marc; Garrido Miguelangel Verde; 2013; 'The Transatlantic Colossus: Global contributions to broaden the debate on the EU-US free trade agreement'

- 'EU Cyber Security Policy in the Age of Snowden'; 2013; Bertelsmann Stiftung

- Felbermayr, Gabriel; Heid, Benedikt; Lehwald, Sybille; 2013; 'Transatlantic Trade and Investment Partnership, Who benefits from a free trade deal?;' Bertelsmann Stiftung

- Felbermayr, Gabriel; Larch, Mario; 2013; 'The TTIP: Potentials, problems and perspectives'; CESifo Forum

- Lannoo, Karel, 2013 'Financial Services and the TTIP'; CEPS

- Petersen, Thiess; 2013; 'Economic Consequences of a Transatlantic Free-Trade Agreement for Asia'; Asia Policy Brief

- Sutton Kara, 2013, 'A summary of negotiations'; 2013; Bertelsmann Stiftung