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SECURITY INSIGHTS

The Transatlantic Trade and Investment Partnership: A Historic Deal?

By Valbona Zeneli

The daily news about America's strategic shift towards Asia and the political narrative on the deep economic crisis of the euro zone has misleadingly suggested that Europe is becoming less and less important in the eyes of the U.S. and that transatlantic ties are weakening. Many scholars and policy analysts argue about the real challenges Europe will be facing in light of these changing transatlantic relations. It seems that conventional wisdom is being guided only by press headlines. A couple of important points have been missed here.

During the June 2013 G-8 Summit in Northern Ireland, the United States and European Union (EU) announced plans to open negotiations on a long sought deal to create a unique market between the world's two strongest economic regions. This joint endeavor, which leaders on both sides of the Atlantic hope will conclude in a final agreement by the end of 2014, is part of the development agenda for creating growth and jobs on both sides of the Atlantic by boosting trade and investment.

Despite continuing economic turbulence on both sides of the Atlantic and new rising global powers, the transatlantic relationship is already the world's largest, accounting for half of the global economic output. The visionary deal would deepen the U.S.-EU bilateral relationship, assert trade policy leadership, and advance a rules-based system for global economic governance.

Very few would have bet some years ago that these parties would be in a position to come so close to real negotiations. The possibility of a transatlantic free trade agreement (TAFTA) between the U.S. and EU was first advocated in 1995 by the former German Minister of Foreign Affairs, Klaus Kinkel, but did not gain any further traction. In his State of the Union address of February 2013, President Obama announced the intent to launch negotiations on a Transatlantic Trade and Investment Partnership (TTIP) with the EU. The idea was developed at the November 2011 US-EU summit, where the High Level Working Group on jobs and growth was tasked with conducting a thorough exploratory analysis to identify policies and measures to increase transatlantic trade and investment with the goals of supporting mutually beneficial job creation, economic growth, and international competitiveness.

Last May, the European parliament finalized the EU's official position for these negotiations, coming up with a resolution supporting it. British Prime Minister David Cameron called it "the biggest bilateral trade deal in the history… a once-in-a-generation prize." The success of the agreement would be also important for discouraging Euro skepticism in the UK, thus making a "Brixit" less likely; this is important, as a UK exit from the negotiations would preclude the UK from participation in the TTIP, since President Obama warned months ago that Washington would not negotiate a separate agreement with London.

The world's largest markets would be served by an agreement that would boost combined GDP by almost one percent in the short-medium term. A market that is completely free of tariffs and barriers could generate an extra $150 billion annually for the EU, $120 billion for the U.S. and provide similar growth for the rest of the world. In practical terms this means two million extra jobs, more choices, and lower prices for consumers.

The TTIP initiative is a geo-economic alignment, taking place at a time when the balance of power is changing; this initiative is designed to stimulate stagnant economies in the aftermath of both the financial and Euro zone crises and to reinvigorate the eroding competitiveness of industrialized countries relative to emerging nations. A successful, comprehensive TTIP would not only boost the transatlantic economy and serve as economic counterbalance to China or other developing powers, but would also allow the U.S. and the EU to remain the strongest global players, able to set the institutional and competitiveness standards for the 21st century for a global open market, rooted in a single set of rules.. Some critics even argue that this

ISSN 1867-4119
No. 9
August 2013

would be the West's last best opportunity to set global rules as the emerging markets continue to gain ground. It would be also a response to the long- standstill in multilateral negotiations for deeper structural reforms at the WTO.

An agreement between the EU and the U.S. would be unprecedented in terms of sheer dimension, a win-win situation for both sides. It would also further open markets, eliminate tariffs, tackle costly behind the border non tariff barriers, open public procurement, facilitate investments by adjusting and converging regulatory provisions, open service markets, enhance cooperation on the development of rules and principles regulating issues of global concern, introduce market-based discipline for state owned enterprises, and promote global competitiveness of small and medium enterprises. Both sides bridging the Atlantic could use the coming decade to leverage global growth, human talent, and innovation while tackling budget deficits and global challenges.

The State of Play of the Transatlantic Economy

The transatlantic economy remains the most dominant and well-integrated force in the global economy, accounting for more than 50 percent of world GDP in terms of value and 41% of purchasing power, in spite of the fact that the number of consumers falling under this agreement would only comprise 11.8 percent of the global population. It is the largest and wealthiest market in the world, at the forefront of global research and development (R&D), and drives global foreign direct investments. With over $4.7 trillion in combined trade and investment, the U.S- EU economic relationship currently dwarfs the $1.5 trillion North American Free Trade Agreement (NATFA) relationship. The transatlantic economy is nearly three times as large as the transpacific economy and far wealthier.

The U.S. remains the most productive and wealthiest large economy in the world by a wide margin, attracting more foreign direct investment (FDI) than any other single national economy ($227 billion in 2011 alone). Europe, too, is one of the main engines of the world economy, accounting for 22% of its GDP and more than one-quarter of global consumption, with high levels of GDP per capita and relevant purchasing power.

Mutual investment is the backbone of this large transatlantic economy, with the U.S. and the EU being each other's primary source and destination for FDI, as a symbol of the deepest form of integration, that binds the partnership together far more than trade, with both parties extensively entrenched and embedded in each other's economies. This relationship produces more income, creates more jobs, and generates more wealth than trade alone, supporting directly nearly 7.6 million jobs, being the largest source of on-shored jobs in each other's markets, with over $4 trillion in mutual investments.

No other place in the world has attracted more American FDI than Europe, with more than 56 percent of global total in the last ten years, for an estimated $212 billion in 2012 alone. The top destinations are the UK, the Netherlands, and Germany, as well as new emerging destinations for U.S. investments in Eastern Europe, such as Poland or the Czech Republic.

Conventional wisdom is that the U.S. is a big investor in China and other emerging cheaper markets. Surprisingly, the data shows that U.S. investment in the Netherlands in 2012 was 14 times larger than in China. According to a study by the Center of Transatlantic Relations of Johns Hopkins University, since 2000, American investment in Europe was 14 times larger than in the BRICS countries (Brazil, Russia, India, China, and South Africa) and nearly four times larger than in Asia. There is more American investment in Germany ($107 billion) than in all of Central America, including Mexico. Investment in Switzerland ($125 billion) is more than double all U.S. FDI in Africa ($57 billion).

Over the last three decades, American and European firms have been building their presence and deepening their footprint in emerging developing countries nations for a variety of reasons, including high growth rates, increasing demand, increasing technological skills, and lower costs. However, investments in developing nations do not mean a retreat from the transatlantic economy. It is more about rebalancing: using global value chains to integrate the value added by other countries into the transatlantic bonds of investment and trade.

This closely interlinked space has gone through many difficulties in the last decades, such as recessions, costly military conflicts, the U.S. financial crisis, the EU sovereign debt crisis, and economic recession, all of which affect each other's economies. The risks are not yet gone, but most improvement is expected in 2013.

Analysts predict that economic prospects for the EU in 2013 include a sluggish recovery, high unemployment rates (especially when it comes to youth unemployment) and further fiscal austerity as a norm against the sovereign debt problems. The U.S. appears to be in better shape, with forecasts of two percent growth rates in 2013, along with growth in employment, but fiscal solvency still remains a big issue and austerity a "must."

In both regions, it seems that the crisis itself has triggered real structural reforms that under normal circumstances would have been much slower. The time has simply come for this new idea, this new visionary plan for a unified and harmonized West, founded on common ideals and interests, not confined by borders or national anthems but based on free trade and innovation. The rise of other emerging powers also seems to have helped increase recognition and appreciation of the common ideals and interests of the transatlantic economy. Success or failure in this deeper relationship will affect not only the two regions, but the entire global economy.

TIPP: A "Free Trade Plus Agreement" between the U.S. and EU

The current proposals for the TTIP go far beyond a simple agreement on free trade and the elimination of tariffs, which are already at low levels. Complete elimination of tariffs is one of the pillars of the agreement. They are already low thanks to past agreements. Weighted average tariffs are approximately 2.8 % on both sides of the Atlantic, however extreme tariff peaks (reaching 87-350 percent) remain in few heavily regulated sectors such as textiles, motor vehicles, and agriculture.

A study commissioned by the German Ministry of the Economy clearly shows that some industries have the potential to benefit greatly from tariff liberalization, with the trade volume so large that eliminating even low tariffs could boost trade significantly, especially in the intra-industry and intra-firm levels. This could have multiple knock-on effects and ultimately result in lower costs and lower prices to consumers. Given the size of the transatlantic economy, even small changes could have big effects.

However, more than 80 percent of welfare gains would come from areas outside of the tariff cutting measures. The core challenge of TTIP is going beyond low hanging fruit, moving the regulatory regimes closer to one another, and addressing the harmful effect of behind the border trade barriers. The bulk of gains is to be found in the elimination of bureaucratic duplication, reduction of red tape, improvement of regulatory alignment, and increased access to services and procurement markets. On the one hand, identifying and statistically quantifying the non-tariff barriers (NTBs) is going to be one the most challenging tasks for the negotiators. On the other, NTBs, when compared to tariff duties, are quantitatively more important and play a much stronger role in restricting trade. This is the reason why substantial gains from a transatlantic agreement require eliminating or at least reducing NTBs.

Reducing market entry fixed costs (quality requirements, administrative hurdles, labeling requirements), establishing e-commerce protocols, resolving data privacy issues, standardizing service related activities, converging procurement rules and regulations, and cooperating in research and development would create a real transatlantic market free of barriers and give incentives to third countries, too.

If simple elimination of tariffs benefits more large firms, a reduction of NTBs appears to be especially useful for small and medium enterprises, leading to an increase in the degree of internationalization of firms. On the macroeconomic level, this would trigger competition in the market, leading to lower prices and an increase in the purchasing power of income, which ultimately result in overall gains for consumers.

Another very important implication of the deal is related to the service market, where protection and regulation is very high. Protected services across the Atlantic account for more than 20% of transatlantic economy, more than the protected agricultural and manufacturing sectors combined. Traditional trade figures show that services, in general, account for less than 25 percent of global trade, suggesting that growth potentials are huge, allowing higher-quality and lower-priced services and enhancing the competitiveness of firms.

The transatlantic service economy leads the world, accounting for 70% of the transatlantic GDP, with the U.S. and the EU each other's most important and profitable markets. One of the main areas of negotiations would be the financial market. Any mechanism included in the deal would elevate the perceived importance of transatlantic financial regulation, and at the same time be a re-commitment to and accomplishment of the previous G-20 principles of financial regulation, consistent with broader global efforts to coordinate financial markets.

However, negotiations will not be easy at all. Zealous proponents of the TTIP, such as the UK, Germany, and the Netherlands, praise the projects, while others are more reluctant. The road to final agreement may have many speed bumps, especially when dealing with different 28 nations in the EU, some of them seeking to preserve tariff barriers and advantages for their potentially (un)-competitive economies. An example is the advantage concession given to France, which almost prevented the EU from agreeing on a mandate, ensuring that its state-subsidized movie and media industry so that it would not be cut adrift to compete directly with Hollywood. Nevertheless, EU and U.S. negotiators have rightly pushed for as few exceptions as possible and have called for comprehensive trade negotiations and avoidance of special treatments. Negotiations on a level playing field for every nation would be in everyone's long term interest; exemptions would limit the effectiveness of the eventual deal.

Strong disagreements or failed comprehensive negotiations would be a truly missed opportunity that neither Europe nor the U.S. can afford. Positive outcomes should not be blocked by special interests. A broad mandate and good understanding among the leaders is of vital importance. Similar economic development levels, strong investment positions, deep political ties (the common defense policy), and high degrees of cultural proximity suggest that the U.S. and EU should find it easier to negotiate. The two economic blocks are sufficiently similar in terms of their cost and productivity structures, making it very unlikely that an agreement involving comprehensive trade liberalization would generate strong competitive effects between the two regions based on different wage levels. The conclusion of the agreement would be a win-win situation; however, this requires high levels of institutional trust.

Effects on the Global Economy

In spite of the advantages mentioned above, the TTIP has already met with opposition from global stakeholders pointing to several obstacles to the success of the agreement. One of the main points of criticism is that such a trade deal would put third countries—such as Canada, Mexico, and Turkey, that already have bilateral agreement either with the U.S. or EU—at a disadvantage, diminishing the value of their agreements. Another criticism is that the eventual deal would jeopardize the functioning of the WTO and hinder successful conclusion of a multilateral agreement (Doha Round). Many others cite the contentious history of the EU-U.S. over trade policies governing global agriculture, intellectual property, and information technology.

Statistically speaking, modern empirical research points at the possibility that the conclusion of important bilateral agreement actually increases the incentives of third parties to achieve further liberalization steps at a multilateral level. This is also good for the rest of the world, given the integrated supply chains in today's global market. Everyone can benefit from the agreement.

Policy makers have drawn lessons from the most recent economic downturn, reflecting on a new development paradigm and revealing that international economic cooperation and integration has become an imperative for addressing the nature of new global challenges. This shift towards broader agreements responds better to today's economic realities, in which international trade and investment are increasingly interconnected. The main objective is the consolidation and harmonization of investment rules worldwide, creating a level playing field for competition. Other agreements being negotiated are the Trans-Pacific Partnership Agreement (TPP) linking North and South America with the dynamic markets across the Asia-Pacific region, the EU-Japan, and the EU-Canada agreements, which are moving quickly toward finalization.

Does a regional agreement like the one between the U.S. and EU reduce the likelihood of successful reforms of the multilateral trade regime under WTO? It has been demonstrated that regional integration efforts are neither a building block nor a stumbling block to the progress of multilateral liberalization. On the one hand, they reduce incentives for participating countries to make concessions at the multilateral level. On the other hand, they increase the benefits from successful multilateral negotiations for initially uninvolved countries. In particular, emerging economies could be persuaded to make concessions.

Regarding the objection that the TTIP agreement would diminish the value of bilateral agreements with third countries, scholars suggest for countries already linked by agreement to either the EU or the U.S. have great incentives to form a deeper partnership with the other partner with whom they do not yet have an agreement. This would allow a U.S.-EU trade deal to eventually serve as a platform for the inclusion of other regions with which both parties have negotiations or agreements. This would be the heart of the building block argument. A deeper bilateral agreement between the U.S. and the EU poses no existential threat to the multilateral trading system; instead, it helps this system to develop further in a more structured form.

The transatlantic economic order, in rules-based system, is unique. In the last decades, it has boosted global economic growthfor a variety of stakeholders, including China. This order has the potential to integrate the rising powers into this system, but strengthening the latter remains a prerequisite.

The TTIP is a timely political, economic and cultural partnership that will boost world economic development, strengthen the natural partnership of the west, and create an international level playing field for fair competition. It will strengthen the bonds within European Union countries. It is a historic step in the making that tremendously benefits both sides of the Atlantic.

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The author is grateful to Professor Michael Czinkota of Georgetown University and Professor Joseph Vann of the Marshall Center for their comments.

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