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Transatlantic Conflict and Cooperation Concerning Trade Issues

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Transatlantic Cooperation and Conflict Concerning Trade Issues

by Joseph A. McKinney*

Transatlantic relations have undergone significant changes within the past twenty-five years. During the Cold War era, the United States and Western Europe were bound together by a perceived common threat from the Soviet Union. Consequently, economic issues commanded less attention than security issues. After the Cold War ended, economic issues were thought to be the glue that would hold the transatlantic relationship together. Much attention was given for several years to fostering economic cooperation through the development of intergovernmental initiatives.

After the terrorist incidents of September 11, 2001 in the United States, and the subsequent wars in Iraq and Afghanistan, security issues again came to the forefront of the relationship. However, in contrast to the earlier era that was mainly characterized by close cooperation, disagreements between the United States and major countries of Western Europe about how to deal with the terrorist threat created severe strains in the relationship. By 2003, the third year of the George W Bush administration, transatlantic political relations had reached perhaps their lowest point since World War II. They have gradually improved since then, but with a significant setback from Wikileaks revelations, and even more serious strains resulting from the revelations by Edward Snowden concerning United States surveillance activities. Security issues have come to the forefront also in connection with regional unrest in the Middle East, EU nations' dependence on Russian oil and gas, and Russian intrusions into Ukraine.

Fortunately, conflicts in the political arena seem to have had minimal impact on the transatlantic economic relationship. Merchandise trade between the US and the EU has doubled in value since 2000, as has trade in services. Given that the US and the EU account for about 45% of world GDP in nominal terms and about 40% in purchasing power parity terms,¹ and given their long history of trading relations, it is not surprising that they are each other's most important markets. Together they account for about 30% of world trade. Much of their economic interaction is driven by transatlantic investment. Together the US and the EU account for about 29% of the flow of world foreign direct investments,² and for about 70% of the stock of world foreign direct investments. (UNCTAD, 2014) Since 2000, Europe has attracted 56% of total US foreign direct investment, with almost 80% of it going to the UK, Ireland and the Netherlands. (Hamilton and Quinlan, 2014). For 2012, US direct investment flows into the EU were \$150 billion, and EU direct investment flows into the US were \$105.9 billion. At the end of 2012, 50.3% of all direct

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¹ Calculated by the author from International Monetary Fund statistics.

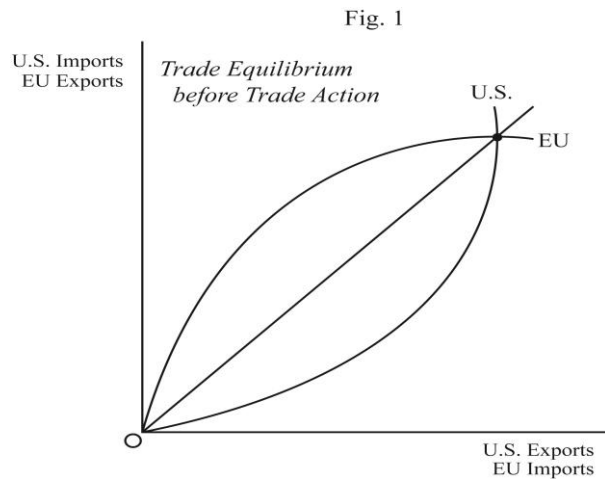
² This is down from 57% during 2007-2009, a reflection of the rise of Asia and other developing economies.

investments by US residents were in the EU, while 62.2% of all direct investments by EU residents were in the US. (Cooper, 2014)

Theoretical Case for Cooperation

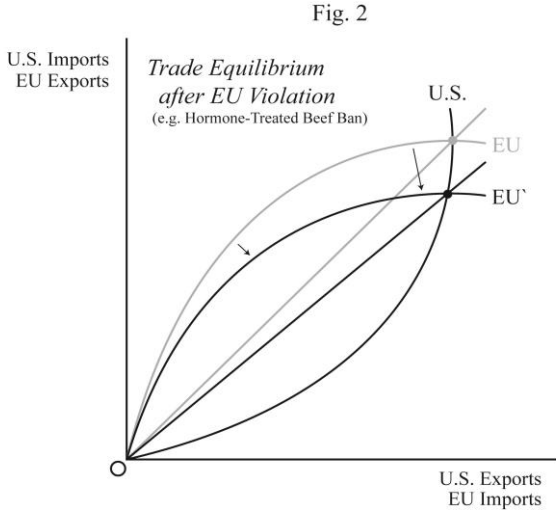
An article of faith among economists is that, in the absence of market imperfections, unrestricted international trade and investment is mutually beneficial to the trading countries and will maximize world production of goods and services. Economists also recognize, however, that a large country can potentially benefit by trade restriction at the expense of its trading partners through improvement in its terms of trade. Conversely, a large country does not necessarily benefit from unilateral trade liberalization because of the terms of trade effect. The rationale for international trade negotiations in which countries balance their trade liberalization through reciprocity is that they can escape the "prisoners dilemma" whereby, while both countries could benefit if they liberalized their trade simultaneously, if either does so unilaterally it loses and its trading partner gains.³

This can be demonstrated using Marshallian offer curves in Figures 1-4. Let us assume as a baseline in Figure 1 that trade between the United States and the European Union is unrestricted. The free trade equilibrium is where the US and EU offer curves intersect.

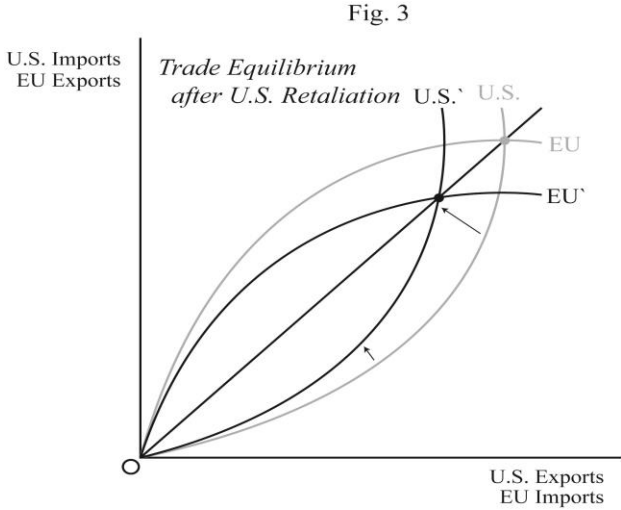


³ For the most completely developed theory of reciprocal trade negotiations see (Bagwell and Staiger, 2002)

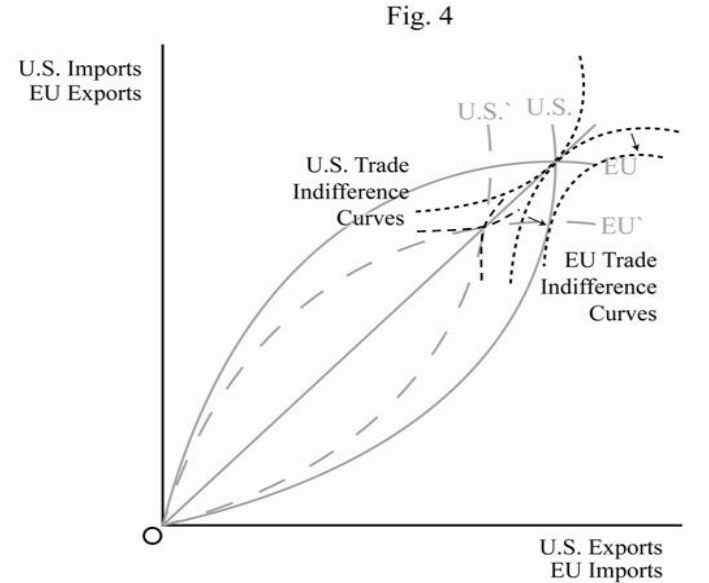
Figure 2 demonstrates the case where some trade restriction is imposed by the EU on imports from the US. Because the European Union is a large trading entity, as its offer curve is shifted down from EU to EU' by the trade restriction its terms of trade improve.



If the United States retaliates with trade restrictions affecting an equivalent volume of trade, its offer curve shifts (Figure 3) from US to US', restoring the original terms of trade.



However, the original EU trade violation and subsequent US retaliation cause the volume of trade to shrink. Both countries will almost certainly be worse off (as indicated by their being on a lower trade indifference curve (Figure 4). Therefore, it is much preferable if, through either trade negotiations or dispute settlement, the trade impediments can be removed (returning to the situation depicted in Figure 1), and the retaliation avoided.



Trade negotiations take place under conditions of uncertainty, however. Trade negotiators strike the best deal that they consider will be politically acceptable according to the imperfect information that they have at the time. But the world does not remain static. Shocks to the system occur because of unforeseen changes in economic conditions, or because the political situation has changed. What was a politically tenable situation before the shock may not remain so afterwards. Therefore, a major benefit of having a dispute settlement mechanism is that it provides an opportunity for renegotiation of the provisions of the trade agreement to take account of changed circumstances. (Hauser and Roitinger, 2002) If an opportunity for renegotiation through dispute settlement were not available, so that provisions of the trade agreement were rigidly applied, then negotiators (and legislators who must approve trade agreements) would be much more reluctant to engage in trade liberalization. Therefore, countries might remain stuck at a lower level of trade (Figure 4) as opposed to moving through reciprocal trade liberalization to a higher level of trade with fewer restrictions (Figure 1).

US-EU Trade Cooperation in Practice

The United States and the countries of the European Union have a strong record of cooperation in international trade matters since the end of World War II. Together they designed and implemented the world trade regime, beginning with the General Agreement on Tariffs and Trade in 1947 and continuing with the World Trade Organization in 1995. They have been dominant players in multilateral trade negotiations from the first round in 1947 through the Uruguay Round in the 1990s. They have also attempted to address bilaterally issues that could not be adequately addressed in the multilateral arena. These efforts have included:

- The Transatlantic Declaration of 1990 that began annual summits involving the President of the United States, the President of the European Council, and the President of the European Commission.
- A New Transatlantic Agenda adopted in 1995 that began regular consultations between interest groups: a Transatlantic Consumer Dialogue, a Transatlantic Labor Dialogue, a Transatlantic Environmental Dialogue, and a Transatlantic Business dialogue.
- In 1998 a Transatlantic Economic Partnership agreement that focused primarily on trade relations. Among its goals were enhanced regulatory cooperation, improved consumer product safety, and mutual recognition of product standards.
- In 1999, a joint statement on *Early Warning and Problem Prevention Mechanisms* that was designed to identify regulations that might inhibit trade before they were adopted
- In 2000, establishment of a *Consultative Forum on Biotechnology* intended to improve communication on biotechnology issues
- In 2002, adoption of *Guidelines for Regulatory Cooperation and Transparency* to improve cooperation by transatlantic regulatory agencies
- In 2004, publication of a *Roadmap for EU-US Regulatory Cooperation and Transparency* aiming for more intensified regulatory cooperation
- In 2005, initiation of dialogues between the US Office of Management and Budget and the European Commission on transparency and risk assessment methodologies, and establishment of a *High-Level Regulatory Cooperation Forum* that brought in academics, business executives and high-level government officials to develop a joint regulatory work plan. (Ahearn, 2009; McKinney, 2014)

While these initiatives have been laudable in their intent, and while some trade liberalization has occurred as a result of them, their contributions beyond what had been agreed in the Uruguay Round has been limited.

As seen in Table 1, both the US and the EU have been frequent users of the dispute settlement procedures of the World Trade Organization. Of a total of 480 cases by all member nations,

Table 1
US – EU Dispute Settlement at WTO

From a total of 480 cases from all nations brought before WTO panels

| | |
|---|--|
| Cases in Which US Complainant 100 (20.8% of total) | Cases in Which EU Complainant 88 (18.3% of total) |
| of which against EU, 9 (9% of US complaints) | of which against US, 22 (25% of EU complaints) |

Source: Calculated from (WTO, 2014)

the US brought 20.8% and the EU 18.3%. Only 9 of the 100 cases filed by the US were against the EU, however, whereas 22 of 88 cases (25%) filed by the EU were filed against the US. Some have been resolved through negotiations arising from dispute settlement cases, such as amendment of the EU banana import regime, rescinding of the Byrd Amendment in the US concerning the payment of antidumping penalties to companies that had brought the cases, modification of the beef hormone ban by the EU, and lifting of steel safeguard measures by the US. Others, such as the dispute concerning airline subsidies and disagreements concerning food safety issues, have proved to be intractable. Fortunately, these trade disputes relate to only about 2% of the total trade between the US and the EU. (Skoba, 2013)⁴

The TTIP Negotiations

The latest attempt to improve cooperation between the US and the EU in trade matters is the Transatlantic Trade and Investment Partnership (TTIP) negotiations. The first round on these negotiations took place in July 2013, with the fifth scheduled to be held in Brussels in July 2014. These negotiations have an ambitious agenda that includes several sensitive and contentious issues that have previously failed to yield to liberalization efforts. In general terms, the aims of the negotiations are:

- “elimination or reduction of market access barriers, including barriers related to trade in goods, services, and investment, including tariff and non-tariff barriers to trade;
- enhanced compatibility of regulations and standards; and
- cooperation for developing rules on global issues of common concern in areas such as intellectual property rights, the environment and labor, as well as in other globally relevant trade-related areas (e.g., state-owned enterprises, localization barriers to trade, trade facilitation, raw materials and energy, small- and medium-sized enterprises and transparency).” (Akhtar and Jones, 2014:8)

⁴ Some disputes involve broader issues such as climate change, but have commercial implications. A case in point is legislation by the US Congress prohibiting US airlines from participating in the EU Emissions Trading Scheme. (Dix, 2014)

One of the easier subjects for negotiation should be the elimination of import tariffs. Tariffs on manufactured goods are already quite low, with a few exceptions. They are considerably higher for agricultural products. The average final bound rate on agricultural products for the US is 4.9%, but with significant tariff peaks for dairy products, sugars and confectionery, and beverages and tobacco. The average final bound rate of the EU on agricultural products is considerably higher at 13.8%, with very high peaks for animal products, sugars and confectionery, and dairy products. (Grueff, Tangerman, 2013) A long phase-in will be required for elimination of the agricultural tariffs, and for some manufactured goods, but with sufficiently long phase-in periods an agreement to eliminate tariffs should be possible.

Whether agricultural subsidies will be included in the negotiations is uncertain at this point. These subsidies certainly distort trade, more so in the US than in the EU. Even though EU subsidies are higher, they have been structured to be less trade-distortive. Changing subsidy regimes will be extremely difficult given the strength of the agricultural lobbies on both sides of the Atlantic, and reformation of subsidy regimes may have to wait for a breakthrough in multilateral trade negotiations.

Related to agriculture, sanitary and phytosanitary issues have been problematic for transatlantic trade for decades. Hormone-treated meats, genetically-modified organisms (GMOs), antimicrobial rinses for meats, etc., are contentious because of strong transatlantic differences concerning food safety. Complete resolution of these differences in trade negotiations is extremely unlikely. When demand for trade restrictions arises from consumers rather than producers, this is a strong indication that cultural attitudes are at play which are unlikely to yield to commercial considerations.

Cultural differences also intrude into the area of technical barriers to trade. The WTO allows countries to impose whatever product standards it considers necessary to safeguard public health, safety, and the environment so long as there is a scientific basis for the standards. The WTO Agreement on Technical Barriers to Trade attempts to discipline product standards or regulations that are imposed for protectionist purposes. But even when they are not crafted to be protectionist, the fact that product standards differ from one trading area to another can impede trade by imposing unnecessary costs on producers. Harmonization of standards is extremely difficult since standards-setting bodies often jealously guard their authority, and in the US regulatory agencies are often found at the sub-national level. Even mutual recognition of standards is difficult because regulatory bodies must answer to domestic legislators and are therefore reluctant to fully trust similar agencies in other countries. (Ahearn, 2009) Greater transparency and consultation/cooperation in the setting of new regulations and product standards may be the best that can be hoped for in the TTIP negotiations.

Government procurement policies will also be an area of much discussion in the negotiations. Both the US and the EU subscribe to the WTO Agreement on Government Procurement, but its coverage is quite limited. The European Commission estimates that only 3.2% of the US government procurement market is open to foreign competition, as compared to 15% of the EU market. (European Commission, 2011) A problem for the US is that restrictions on government procurement originate at the sub-federal level.

Reportedly, both the US and the EU have agreed to a negative list, whereby government purchases of goods or services not on the list would be automatically open to foreign competition. (Hufbauer, 2014)

Services trade will be an important part of the TTIP negotiations. Services account for an estimated 36% of US-EU trade in value terms (Slater, 2013), and closer to 50% when trade is measured in value-added terms. (OECD-WTO, 2013) Since delivery of services often requires investment in the country, and because some service sectors are sensitive in national security terms, services trade negotiations tend to be complex. Reportedly, the US and the EU have agreed in principle to a negative list for the services negotiations as well. (Hufbauer, 2014) This should simplify matters since the US previously worked from a negative list and the EU from a positive list. The EU is pushing hard for inclusion of financial services in the negotiations, while financial authorities in the US are strongly resisting their inclusion.

Investment regulations will also be a contentious issue in the negotiations. To this point the US has had bilateral investment treaties with individual EU countries, but under terms of the Lisbon Treaty the European Commission has sole competency for this area. The Commission is working gradually toward an EU-wide investment treaty that would consolidate the bilateral treaties. (Schott and Cimino, 2013) Investor protections under investor-state dispute resolution provisions are being strongly resisted by civil society groups on both sides of the Atlantic who fear that such provisions could put at risk health or environmental policies. Since both the US and the EU have strong investor protections in their legal systems, the focus should perhaps be on investment liberalization, which will be challenging enough in sectors such as transportation, energy and communication.

There exist a number of other issues that will prove contentious in the negotiations, such as data privacy, geographical indications, and protection of cultural industries. Negotiators will have to remain flexible and aware of political sensitivities in order for the negotiations to succeed. Intransigence on either side could be fatal to the negotiations.

Conclusion

As the two largest economic entities in the world, the US and the EU play a crucial role in the global economy. That they cooperate concerning trade matters and keep conflict to a minimum is important. Fortunately, in the post-World War II period they have a commendable record in this regard. Trade and investment flow relatively freely across the Atlantic. In such a large and dynamic relationship, some conflicts inevitably emerge. The US and the EU have been frequent users of the WTO dispute settlement mechanism to sort out their differences, and a number of contentious issues have been resolved in this way. Others, however, have proved to be more intractable. Often these have been in areas such as food safety where the demand for protection comes primarily from consumers, reflecting cultural differences. Agriculture and tax/subsidy policies have also been problematic.

Potential exists in the TTIP negotiations for further cooperation in trade matters. However, the easier issues have for the most part already been dealt with, leaving the more complex and politically sensitive ones to be addressed in these negotiations. Both the US and the EU would be well advised to approach the negotiations with pragmatism, realizing that there are limits to what may be accomplished in politically sensitive areas.

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