

EU-US trade: inflated expectations

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Summary

The European Commission is set to commence the negotiation of a Transatlantic Trade and Investment Partnership with the US. The five year hiatus since the stalling of the WTO Doha Round of global trade negotiations, and the political need in a number of EU capitals - and Washington to a lesser extent - for a big strategic gesture has opened up the political space for a big new bilateral trade initiative. However, the grand strategic flavour of the initiative is also at risk of inflating political expectations of what the deal will deliver and how quickly.

June 2013 should see the adoption by the EU of a mandate for the European Commission to commence negotiations with the US on a Transatlantic Trade and Investment Partnership (TTIP) with the US. The idea of a trade agreement between the two largest markets in the world has long been seen by both sides as too difficult or too distracting from the larger prize of a multilateral WTO trade agreement to merit serious attention. However the five year hiatus of world trade negotiations since the stalling of the Doha Round has opened up the political space for a big new bilateral initiative.

The idea of a big transatlantic deal has also tapped into a political need in a number of EU capitals - and Washington to a much lesser extent - for a big strategic gesture after five years becalmed by the downturn. However the grand strategic flavour of the initiative is at risk of inflating political expectations of what the deal will deliver, and how quickly. Businesses supportive of an EU-US agreement need to calibrate their expectations carefully.

Negotiating regulating

Although it is sometimes described in the media as a Free Trade Agreement (FTA), the proposed EU-US deal bears little resemblance to most FTAs negotiated under the framework of the WTO General Agreement on Trade and Tariffs (GATT) which focus mainly on reductions in tariff duties. EU-US trade is already largely free of tariffs, although there are still isolated

high duties in textiles, vehicles and some farm goods. Most of the advocacy for the deal has used average tariffs to make the case for the negotiation, but weighted for the trade profile between the two markets the average trade-weighted tariff on EU manufactured goods in the US is just over a negligible 1% (compared to around 7% for Chinese manufactured goods). Agricultural tariffs are slightly higher, but not much (Fig 1). About two thirds of manufactured exports and half of all farm exports between the two markets by value pay no tariffs at all. This is about as free as trade in goods gets between WTO members, especially for manufactures (Fig 2).

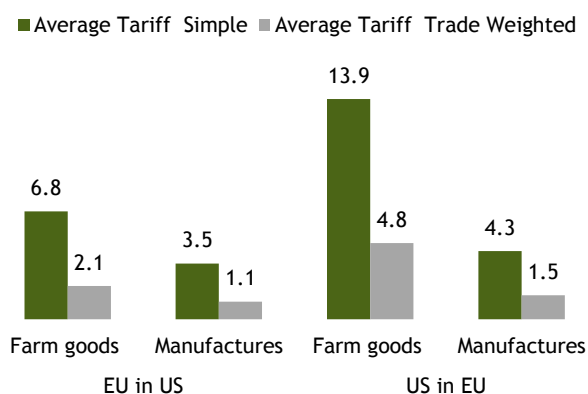


Fig 1: Average tariffs, EU-US trade (%)
Source: WTO

The bulk and substance of the negotiation will be questions of regulatory convergence between the two markets. Here officials on both sides privately admit

that they are attempting something unprecedented in both scope and political complexity. Plenty of existing bilateral FTAs have regulatory chapters, but these typically reflect the asymmetry in weight between the EU or the US and another much weaker negotiating partner. Often these negotiating partners, especially in the developing world, have in any case only embryonic regulatory regimes of their own.

This obviously cannot be said of the US and the EU. Both are prolific regulators, with the parochialism that comes with large, mature, wealthy markets, and they are not particularly bothered about the extraterritorial spillover effects of their domestic regulatory cultures. We have seen this repeatedly over the last five years as both sides have refined their regulatory regimes for financial services.

It will take a huge measure of clear political direction for the exhausted bureaucracies of financial regulation on both sides of the Atlantic to warm to a new process of regulatory alignment. In Europe public defensiveness about the perceived lowering of some key public safety standards to US levels will also be very high.

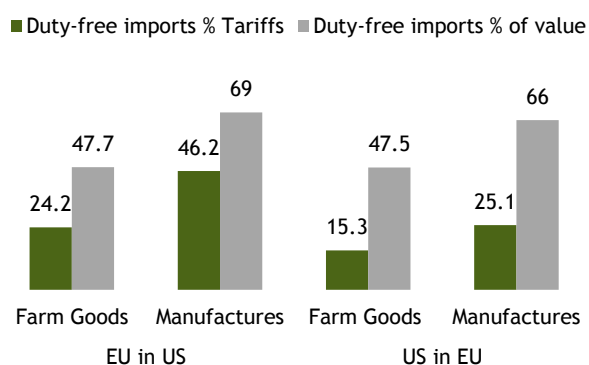


Fig 2: Tariff-free trade, EU-US
Source: WTO

Bringing regulatory change into trade negotiations in any case requires a complicated practical process of integrating regulators early in the process alongside trade officials. With a different worldview and sense of mandate, and often with a different political constituency this is rarely simple. The trade

landscape is littered with examples of deals that have stumbled on a lack of communication or common purpose between weaker trade ministries and the domestic baronies of financial or industrial regulation.

This ultimately is what lies behind the concern that the deal will struggle to address questions like the EU's use of the precautionary principle in regulating genetically modified food, or its generally higher standards on preparation of meat for consumption. Moving European member states off entrenched regulatory positions is in any case likely to be made more difficult by the current combustible state of politics in Europe. The European Commission has already made it clear that it will not renegotiate its basic legislation through the TTIP, a position which jars with the explicit expectation from senior members of the US Congress that changing the EU approach to food safety should be a US priority for the negotiation.

The process of agreeing negotiating mandates for both sides is likely to flush out some of these prospective issues even more clearly. Paris is already pushing to have some cultural products excluded from the negotiating mandate to guarantee protection of French subsidies and quotas for French language content. The Trade Committee of the European Parliament has backed Paris and the Parliament as a whole will vote on its preferences for the negotiating mandate in early June. Although the Parliament's view is non-binding on the Commission, it would strengthen Paris' hand significantly. The Commission will inevitably fear that going into the negotiation with an explicit redline on cultural issues - on which the EU would in any event be expected to give no ground - will simply allow the US to carve out its own protected areas.

The US Congress too is likely to add its own list of expectations to any approval of the US President's Trade Promotion Authority status, which the White House is expected to seek shortly. This has lapsed since 2007 and allows the President to conclude trade agreements for Congressional approval or rejection rather than line-by-line amendment. The Congressional shopping list will be sure to include

reductions in EU agricultural tariffs and a revision of the EU's 'non-scientific' approach to food regulation. The US agricultural lobby is already defining success in this negotiation as new market access for US farm exports, a political contingency that ultimately helped sink the Doha Round of WTO negotiations in 2008.

From the big picture to the small print

None of this is to dismiss the prospects or potential for an EU-US deal. The hypothetical prize of regulatory convergence is very real and very much the next frontier for trade policy. Commodity prices are comparatively high, which should make it easier in principle to address sensitive farm tariffs in areas such as meat and cereals, and leave political capital left over for regulatory chapters. There is a genuine desire, especially in Washington, to build a new parallel structure of trade and investment liberalisation outside the WTO and to the exclusion of China, to re-energise the wider trade liberalisation agenda on US terms. Whether these things are a substantial force for compromise is of course the big question.

Nevertheless, some political leaders in the EU in particular seem to be inviting disappointment. Political expectations of the deal, especially on the EU side, are sky high, and they are unrealistic. The grand strategic dimension of the negotiation has added to its political appeal in Europe and there are a number of EU states - not least the UK- who see the deal as a new symbol of North Atlantic unity and European internationalism and commercial focus.

This probably misreads the landscape in two key ways. First, Washington is much more concerned with completing its wider and more advanced Trans-Pacific Partnership (TPP) agreement with South East Asia and Japan, which is the centrepiece of its China encirclement strategy. It is not even totally clear that US officials do not see the primary value of the EU negotiation at this stage as adding additional pressure for a swift conclusion of the TPP.

Second, the reality is that once the negotiation starts it will move from the purview of the politicians to

that of the negotiators. The two year political timeframe for completing the negotiation is probably realistic for a basic negotiation on trade in goods. But few officials on either side believe that it is realistic to expect a conclusion on regulatory convergence on that timescale. Congressional and European Parliamentary approval would in any event add months to any process. As political focus wavers and political constituencies dig in, this two year target will either slip, or imply a quick and probably cosmetic agreement.

For businesses with a commercial interest in a successful EU-US agreement this implies a number of important things. They will need a willingness to play a long game - sustaining political pressure across a wide range of constituencies for a process that could easily span years. The WTO Doha round (which started with a similar burst of grand strategy optimism after September 11) ended up demanding a decade-long attention span from business, and much of the corporate sector had lost interest or conviction long before their concerted pressure might have improved the odds on a final deal in 2008. The TTIP is a bilateral deal which reduces the complexity by an order of magnitude, but business should not let the grand strategic talk obscure the prospect of a long slog ahead.

Even more importantly, business will also need to recognise that more than any previous agreement, lobbying will need to be focussed on their own domestic regulators as much as on pushing offensive interests. Most trade negotiations rapidly become a trade-off between offensive concessions on both sides and it is easy to see how this will slow and even undermine an EU-US deal. Negotiators on both sides are relying on industry to help filter the key issues for focus. But one of the key challenges for business will be presenting their home regulators with the case for harmonisation and with pragmatic strategies for compromise.

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