The Issues and Benefits of the U.S. - European Free Trade Agreement

Earlier this year, the White House announced plans to begin negotiations with the European Union (EU) on a free trade agreement. If successfully concluded as currently envisioned, this deal would cover approximately 50 percent of global output, nearly 30 percent of world merchandise trade, and 20 percent of global foreign investment, according the OECD, an independent organization that promotes policies to improve global economic prosperity.

Known formally as the Transatlantic Trade and Investment Partnership (TTIP), the deal is anticipated to cover industrial and agricultural products, services, investor protection, government procurement, technical product standards such as environmental rules for vehicles, and a mechanism for settling disputes between the parties. This ambitious and complex agenda could reshape global standards by uniting two international economic powers. It also could create tensions between the United States and the EU due to problematic issues that have been difficult to remedy.

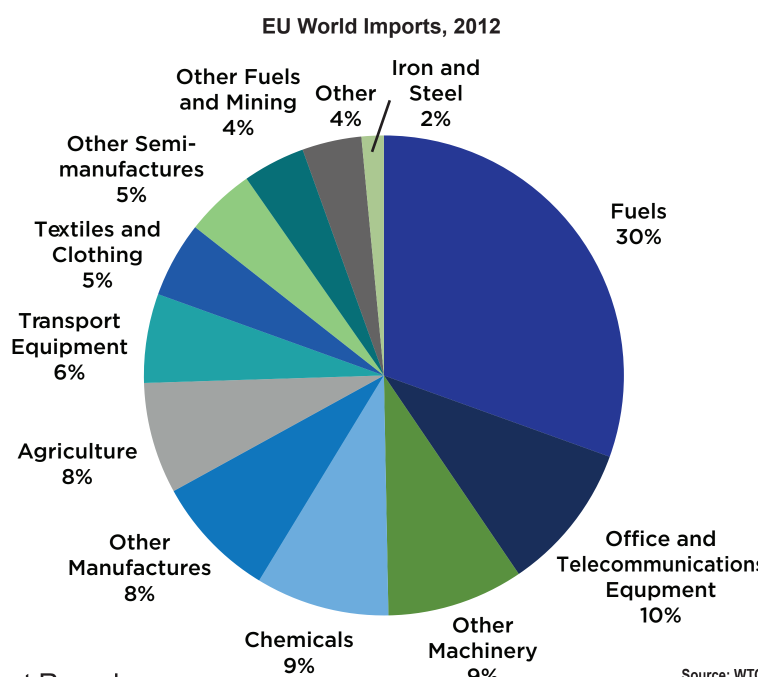
The Problem with Non-Tariff Barriers

Like many free trade agreements, major benefits are accrued through the elimination of tariff barriers. With regard to U.S.-European trade, however, the average tariff on bilateral trade already is a low 3 percent, the OECD says. Nevertheless, the U.S. Chamber of Commerce reports that their elimination alone could boost the combined gross domestic product (GDP) of both the United States and EU by $180 billion five years after implementation of the agreement.

The largest benefits from TTIP, however, are likely to come from a reduction or elimination in non-tariff barriers (NTBs) to trade and investment. But here lies the real difficulty.

Much of the growth in international trade since World War II has been attributed to reductions in tariffs. However, many obstacles to trade over the last one to two decades have been the result of new and sophisticated NTBs. And the United States and Europe are not exempt.

NTBs include specific limitations on import quantities, onerous customs and administrative entry procedures, and standards and regulations that are difficult to understand and satisfy. In many cases, NTBs, sometimes referred to as red tape, cannot be quantified but can effectively keep products out of markets.



But the impact of NTBs goes even further. Analysts say they have been the main culprit in the stalling of the Doha Development Round, the current World Trade Organization negotiations which began in 2001. The round essentially came to a halt in 2008 due to disagreements on the future of NTBs, including agricultural subsidies, international standards, and trade rules for services.

U.S.-EU Trade Is Fraught With Problems

Successfully taking on and remedying contentious EU NTBs will be key to an American successful negotiation. From the U.S. perspective, EU NTBs involve agriculture, intellectual property, services, government procurement, and regulatory compliance, among others.

According to the OECD, real benefits would be achieved if public procurement markets at all levels of government were opened to both American and EU firms. Fiscal savings from reductions in the cost of procurement would be expected in the very short term. This, however, could be a difficult objective to achieve.

Harmonizing EU and U.S. regulations would be extremely advantageous, but it would prove a difficult task to accomplish. It could be an even more arduous undertaking if it involves genetically modified crops and hormone-treated beef and chicken, analysts say.

Plus, the elimination of farm subsidies could produce a tremendous upside. According to *The Wall Street Journal*, the EU spends $52 billion annually in direct payments to farmers alone. The United States spends about $11 billion in direct payments and is the third largest subsidizer of agriculture after Japan, the *Journal* says. The problem: farm lobbies in both the U.S. and EU are highly effective, and as a result, farm subsidies are difficult to tackle.

Another hurdle to a successful free trade deal involves labor. Worker rights, which have been included in recent U.S. free trade agreements with smaller and less developed countries, would be much more contentious with the EU, which has very different views on labor, says Helena D. Sullivan, an attorney with Barnes, Richardson & Colburn, LLP. Overcoming such difficulties on such complex issues, she says, would be a major undertaking.

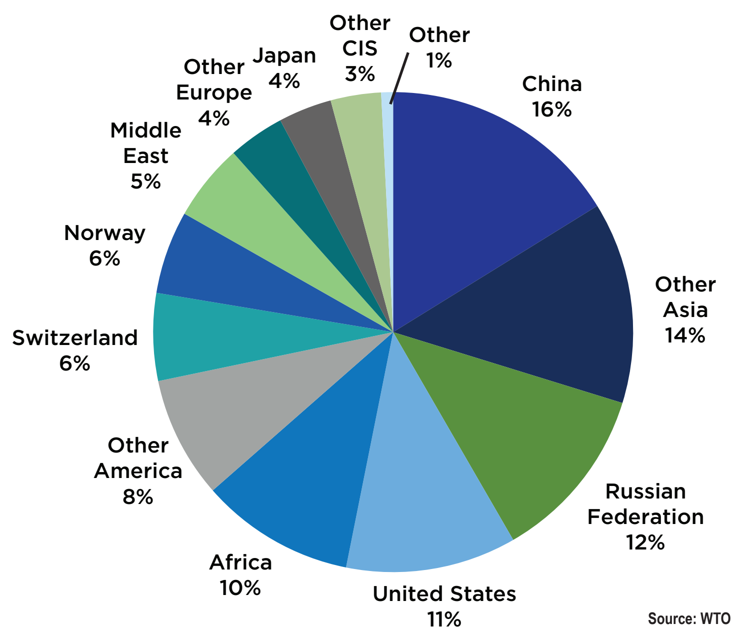
Overall Projected Benefits Are Large

How big could the benefits be if tariffs and NTBs were eliminated? The OECD says potential welfare gains to the European Union and the United States could be as large as 3 to 3.5 percent of GDP. Other studies, the organization says, estimate gains ranging from 0.5 to 3.5 percent of annual GDP; and one study puts these gains at as high as 13 percent for the United States and 5 percent for the European Union.

These projections do not incorporate the benefits resulting from productivity gains, which many economists argue are a major result of trade and investment liberalization. Overall, a U.S.-EU free trade deal could act as an inexpensive stimulus at a very important time.

In addition to economic gains, closer ties with Europe could reinforce cooperation in other areas, such as defense. Analysts say U.S. officials have worried for years that budget cuts in Europe have left a burden on the U.S. defense budget, which is currently under pressure.

EU Sources of Imports, 2012



Source: WTO

The gains associated with a U.S.-EU free trade agreement are enormous and would provide U.S. exporters and investors with preferential access to EU customers. Obstacles to such an agreement, however, may be even greater than potential gains. Nevertheless, if successfully concluded, the deal could be a model for future agreements with other countries and regions around the world.

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