Atlantic unity in global competition

T-TIP in perspective

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The rapid rise of China in world trade has put pressure on the established trading powers. The US and the EU are seeking to respond to this development with an agreement on the Transatlantic Trade and Investment Partnership (T-TIP). As these two parties are responsible for the majority of international transactions, increased Atlantic unity could strengthen their competitive position internationally.

An agreement would increase growth and employment in both regions. Bilateral trade and investment activity are likely to rise. Economic benefits outweigh the risks.

The greatest economic opportunities lie in improved cooperation in the regulation of markets for goods and services. The lion's share of the economic advantages must be achieved by breaking down technical barriers to trade and opening what are currently heavily protected, company-specific service industries. Regulatory cooperation will have to be raised to a new level if this is to happen.

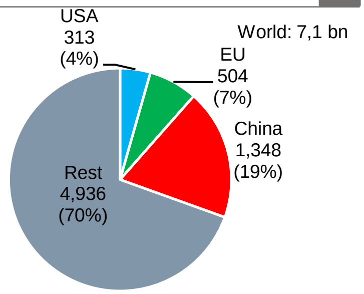
The political prospects for an ambitious agreement are currently favourable. Governments, parliaments and most interest groups on both sides are in a positive mood; the resistance to an agreement has thus far been limited to criticism of some details.

The greatest political difficulties are likely to arise in the areas of agriculture and data protection. Protected agricultural interests in the EU and the US must be overcome, bureaucratic-regulatory divergences in technical trade barriers must be reduced and both culturally and politically sensitive issues must be delicately defused. The fundamental dispute about the right way to protect personal data in the evolving Internet economy is likely to be one of the biggest hurdles.

The effects on the international trade system are complex. Economically, the creation of trade and investment opportunities for third countries predominates. In contrast, the planned transfer of the effective development of regulations from the multilateral system to a bilateral relationship is risky in terms of regulatory policy. An attempt to extend preferential agreements multilaterally is unlikely to clear the political hurdles. An Asian counterweight to this is unlikely in the medium term.

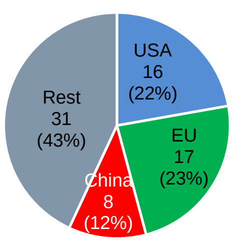
Content

Population, 2011 | 1



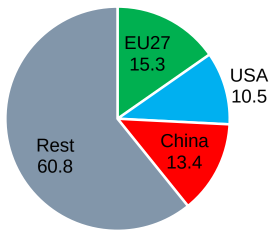
Sources: UNO, Eurostat

GPD at market prices, 2012 | 2



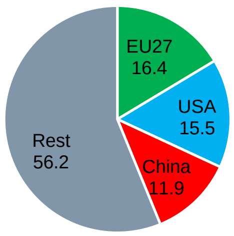
Source: IMF

Share of world exports | 3



Source: Eurostat

Share of world imports | 4



Source: Eurostat

A transatlantic agreement on trade and investment: Why?

The two sides had hesitated for nearly a year and a half as they extensively reviewed this major undertaking. Political leaders on both sides had established a high level working group for jobs and growth at the EU-US summit on 28 November 2011; the aim of this working group was to develop the framework for future negotiations, and it accomplished this goal.[1] The time came on 12 February 2013. In his State of the Union address before both houses of Congress, President Obama gave the green light to the start of negotiations on the creation of a comprehensive *Transatlantic Trade and Investment Partnership* (T-TIP) between the US and the European Union. The next day, in a joint memorandum, Obama, European Council President Van Rompuy and Commission President Barroso declared that both sides would now initiate the formal steps for trade negotiations.[2]

With this step, the US and the EU took international trade policy at least temporarily in a new direction. The frustration of the two trading powers at the deadlock in multilateral negotiations – the Doha round of the World Trade Organization[3] – had in recent years led both parties to believe that significant progress in opening markets and improvements in the regulatory framework could only be achieved through a number of bilateral or interregional agreements. Accordingly, the Obama administration's Trans-Pacific Partnership Initiative (TPP) has targeted nearly 20 countries in Asia and the Pacific[4], while the EU, as part of its "Global Europe" strategy, has intensified its efforts and concluded new bilateral and interregional agreements with, among others, India, Japan, Canada, MERCOSUR, Central America, ASEAN and other partners since 2006. An important agreement with South Korea was concluded in 2012.[5]

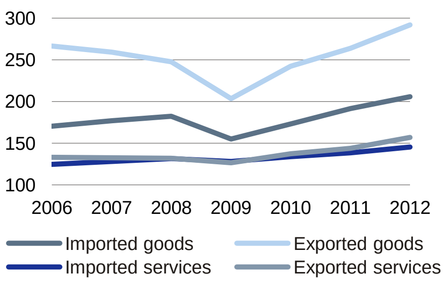
These trade policy projects are intended to help the EU maintain its leading role in world trade and to make a significant contribution to growth, welfare and employment. For the EU, an agreement with the US would raise the share of preferential trade in its total foreign trade from about a quarter before 2006 by more than 15 percentage points; and with full implementation of the bilateral strategy, this would increase to three quarters. For the US, in turn, the ongoing negotiations would have significantly less impact given the lower volume, the lower base and the lower potential. The EU hopes that the resulting expansion of trade and the greater openness will provide a boost to growth, income, consumer welfare, employment and labour productivity in the medium term.

However, the transatlantic relationship is different from the other bilateral or regional projects of both sides so far, because two of the three largest foreign trade powers in the world are choosing to deepen bilateral economic relations with the explicit aim of strengthening existing world trade rules, creating new rules with a global scope, and, if possible, in a second step anchoring them multilaterally in the World Trade Organisation. For the United States, the project complements its Pacific strategy around China with a European component. For the EU, in turn, the project closes a significant gap in its strategy of concluding bilateral and interregional agreements. The economic opportunities of a transatlantic agreement are great for the simple reason that each party is

[1] The recommendations of the HLWG (2013) were published a day after Obama's speech before Congress and another bilateral declaration by Obama and the EU Council and Commission Presidents.
[2] European Commission (2013a).
[3] See Deutsch (2011a).
[4] See Petri, Plummer and Zhai (2013). Schmucker et al. (2012) and Deutsch (2011b).
[5] See Deutsch (2012) and European Commission (2010, 2012a).

EU trade with the USA 5

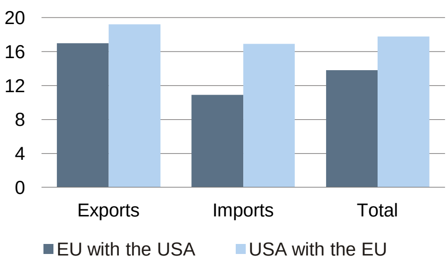
in EUR bn



Source: Eurostat

Share of foreign trade 6

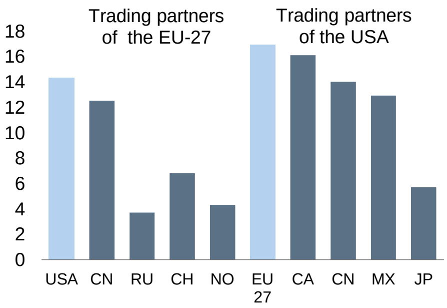
in %, 2011



Source: Eurostat

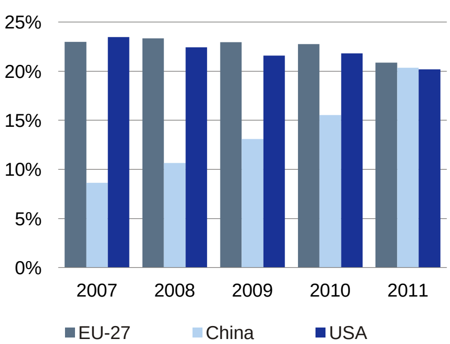
Major trading partners of the EU and the USA 7

in %, 2012



Sources: Eurostat, US International Trade Administration

Patents 8



Source: WIPO

negotiating with its most important partner market for direct investment and trade and relatively major effects can be achieved by eliminating barriers.

The sheer volume of exchange ensures that the elimination of even relatively minor barriers would have a considerable impact in absolute terms. In addition, progress in bilateral relations has lagged behind expectations on both sides since the Transatlantic Economic Council was created in 2007.[6] Further, the bilateral trade in goods has been growing at a pace well below average over the past decade, with the result that the US share of EU imports and exports has dropped by nearly half.[7] This has fuelled hopes on both sides that a major step could now be taken to move deep integration forward.

However, this bilateral exercise quite probably also serves to defend the two parties' global position, which has come under pressure, particularly from China. In any case, however, the EU has at least halfway met the rise of China in the last decade and since 2001 it has lost just three percentage points each in the trade in goods and services (while the US has lost six and two points, respectively), while China has gained ten points in the trade of goods and just two points in the trade in services (since 2004). But the EU is a mixed bag, as can be seen in the trade figures. Among the EU Member States, Germany, in particular, and the Central and Eastern European countries have increased their share of world trade and of EU exports in the last decade, while, in decreasing order, the United Kingdom, France, Italy, Belgium and Finland have each lost more than ten points and have a lower share of EU exports. The Netherlands, Sweden and Spain have more or less held steady.[8] These shifts in relative competitiveness are also reflected in trade within the internal market. For the US, in turn, the export economy has played a larger role since the crisis erupted. The Obama administration has launched a national export offensive and is supporting the strengthening of industrial value creation through increased trade.

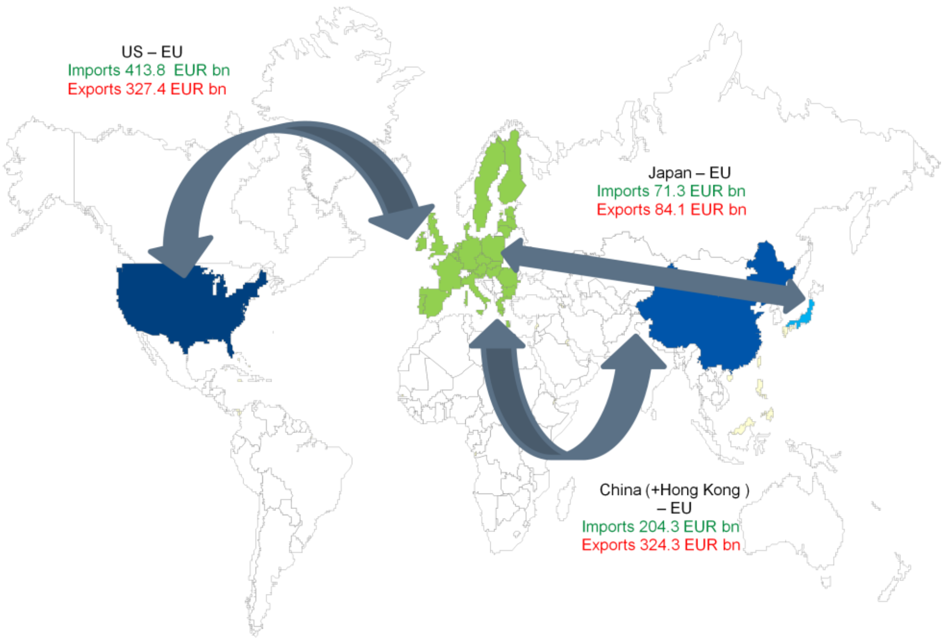
Of course, the transatlantic project also sends a very strong political signal that, despite the continuing upheavals in the financial system and the economy as a whole, the leading powers of the post-war global economic order are willing to make a joint trade policy contribution to growth and welfare, to meet the economic challenges posed in particular by the emerging economies of Asia, especially China, and as market powers to take a leadership position in formulating the regulatory framework and diplomacy.

The state of the economy itself was also a key to the change of heart in favour of a comprehensive agreement. The companies and their associations in the United States which were deeply involved in trade and investment in Europe had placed little emphasis on trade policy since the completion of the Uruguay Round in the mid-nineties. This has changed in recent years, especially as the US Chamber of Commerce put its weight behind a demanding course with a particular focus on Europe. In the EU, companies had for a long time given priority to multilateralism over transatlantic special agreements, and very broad support was not found for the latter approach again until Doha Round reached an impasse. It is now probably true to say that virtually all industries support an agreement. In any case, the major business associations support the project very strongly.

6 Deutsche Bank Research (2007).
7 European Commission (2013c).
8 Information from the European Commission (2013b).

Economic relationships

Trade in goods and services with the EU-27 9



Source: European Commission

USA key data 10

Population (2010)	312 million
GDP (2012)	EUR 12.6 trillion
GDP per capita (2012)	EUR 40,200
Exports as % of GDP	6.9%
Imports as % of GDP	10.6%
Gross value added (2010)	
Agriculture as % of GDP	1.2%
Industry as % of GDP	20.0%
Services as % of GDP	78.8%

Sources: UN, Eurostat

EU key data 11

Population (2010)	501 million
GDP (2012)	EUR 12.9 trillion
GDP per capita (2012)	EUR 25,600
Exports as % of GDP	12.5%
Imports as % of GDP	13.7%
Gross value added (2010)	
Agriculture as % of GDP	1%
Industry as % of GDP	26%
Services as % of GDP	73%

Sources: UN, Eurostat

When viewed more closely, the degree of economic interdependence between the US and the European Union exceeds the public perception significantly. The two economies with a total of 817 million citizens (11.7% of world population, 2011) not only are responsible for 45% of global economic output (at current prices and exchange rates, 2012),[9] but almost a third of the global trade in goods, two-fifths of the trade in services, and three-fifths of all direct investment.

Investments

The clearest mark of transatlantic economic interdependence is the dense network of investments made in the markets of these partners by international companies.[10] These companies have largely adapted to local conditions and are now barely distinguished in the public perception from domestic companies.

The economic importance of this bilateral investment relationship can hardly be overestimated. With a combined total of almost EUR 2.5 trillion in investments in each other, the EU and the US not only represent three-fifths of all global foreign direct investment (FDI), this bilateral total is also around five times higher than the level of European-Chinese or EU-Latin America investment. The EU is also the target of half of all US foreign direct investment and three-fifths of all direct investment in the United States originates in the EU.

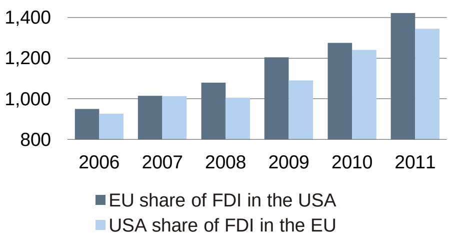
The level of direct investment made by European companies in the US increased by 95% between 2004 and 2011 to EUR 1.4 trillion. British companies lead the way here (18%), followed by French, German and Dutch companies (13% each). Conversely, US investment in the EU for the same period increased by 75% to EUR 1.3 trillion. The United Kingdom is by far the favourite destination of this investment, followed by France, Germany and the Netherlands.

9 Measured by purchasing power parity, nearly 40% (38.8%, 2011) of global economic output is generated by the EU and the US.
10 See Hamilton and Quinlan (2013) with numerous illustrations of the phenomenon, all figures from Eurostat or the US Bureau of Economic Analysis unless otherwise indicated.

Atlantic unity in global competition

FDI stocks 12

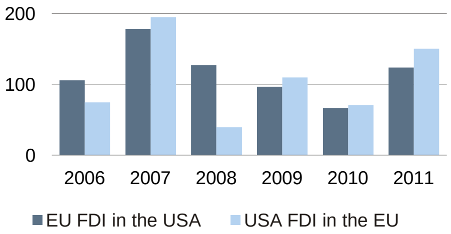
in EUR bn



Source: Eurostat

FDI flows 13

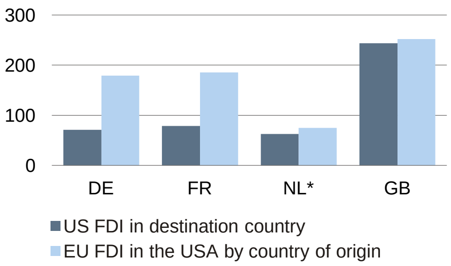
in EUR bn



Source: Eurostat

Direct investment (stocks) by main destination country and country of origin, 2011 16

in EUR bn, 2011

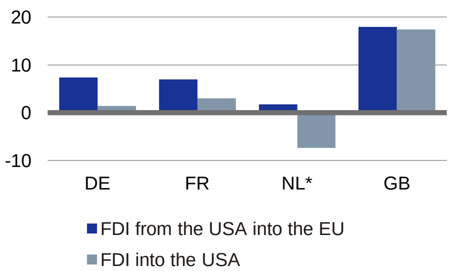


* recorded using a different method

Source: Eurostat

Direct investment (flows) by main destination country and country of origin, 2011 17

in Mrd. EUR, 2011

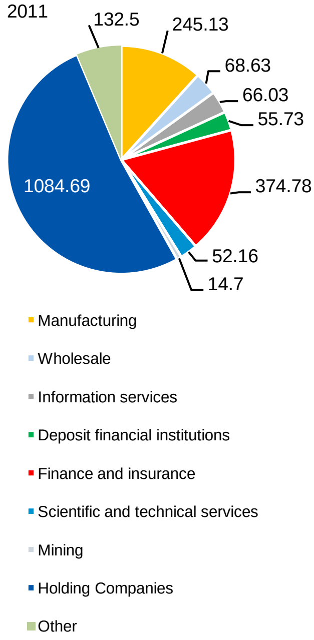


* recorded using a different method

Source: Eurostat

FDI level of US companies in the EU by sector 14

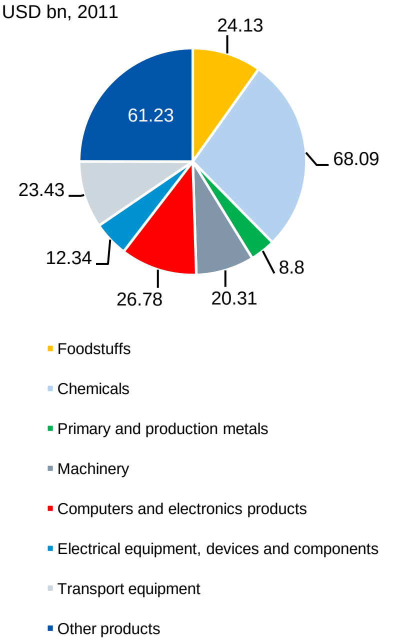
in USD bn, 2011



Source: Bureau of Economic Analysis

FDI level of US companies in the EU in the manufacturing sector 15

in USD bn, 2011

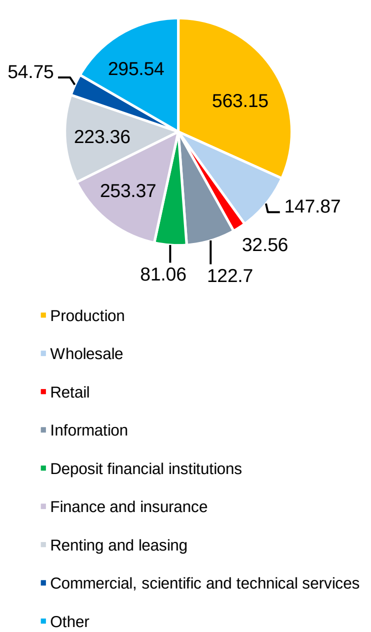


Source: Bureau of Economic Analysis

The Eastern European countries, especially Poland, have also increasingly become investment targets. EU investment in the US (flows) decreased from 2008 to 2010 from EUR 126 billion to EUR 20 billion, but recovered again in 2011 to EUR 111 billion. In contrast, US investment in the EU fluctuated from year to year between EUR 35 billion (2008) and EUR 115 billion (2011). France, Ireland, the Netherlands and Spain have experienced brief phases of de-investment by US companies since the beginning of the crisis in 2007, while the US has seen de-investment from individual EU countries only in a few years.

FDI level of EU companies in the USA by sector 18

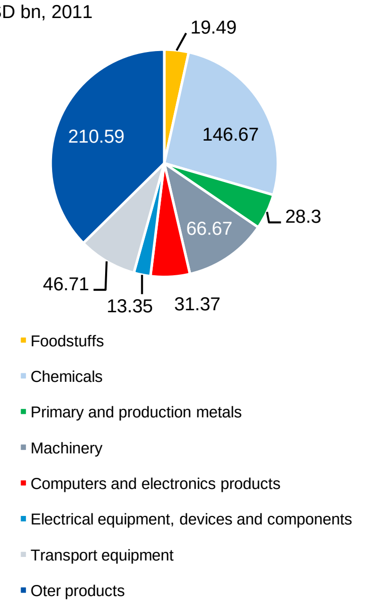
in USD bn, 2011



Source: Bureau of Economic Analysis

FDI level of EU companies in the USA in the manufacturing sector 19

in USD bn, 2011



Source: Bureau of Economic Analysis

Investments seem to have turned around and found a post-crisis pattern in 2011. The US market was the target of just over 16% of all EU direct investment in 2011, while US investors were responsible for nearly 20% of the investment in the EU.

A varied picture emerges when investments are broken down by industry: US direct investment in the EU by industry is led by holding companies (52%), banks and insurers (21%) and manufacturing (12%). EU companies are invested in the US as follows: 36% in manufacturing, 21% in banks and insurers and 12% in trade.

The gross value added of US subsidiaries in the EU totals over one trillion US dollars; in Ireland, a full quarter of the country's economic output comes from US subsidiaries. The subsidiaries of US companies generate revenues of USD 2.5 trillion and employ 4.1 million people in the EU, while the subsidiaries of EU companies in the US have 6.4 million employees and revenues of USD 3.5 trillion. The income and earnings of the subsidiaries are substantial (in 2011, US companies generated USD 177 billion in income from direct investment in the EU and EU firms generated USD 93 billion in revenues in the US).

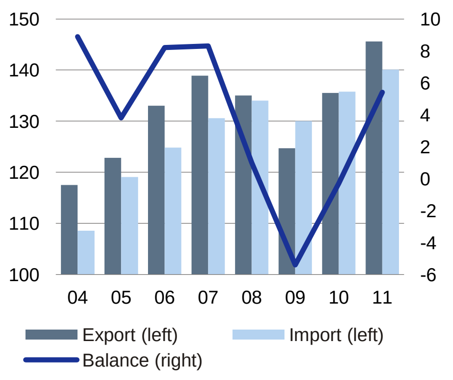
Trade in goods

Breakdown of EU trade with the USA by goods 20

	Imports	Exports
Total	EUR 206 bn	EUR 292 bn
Machinery and cars	38.3%	41.4%
Chemicals	21.2%	22.7%
Other industrial products	12.4%	11.5%
Fuels	9.6%	6.7%
Industrial products	6.3%	10.1%
Commodities	4.2%	0.7%
Industrial commoditites	4.0%	0.9%
Foodstuffs and animals	2.5%	1.9%
Beverages and tobacco	0.7%	2.7%
Oils and fats	0.1%	0.3%

Source: Eurostat

EU trade in services with the USA 21



Source: Eurostat

With foreign trade in goods of EUR 3.3 trillion and a 16% share in global trade, the EU remains number one in world trade, followed by the US (EUR 2.7 trillion, 14%) and China (EUR 2.6 trillion, 12%). The EU and US combined are thus responsible for 30% of the global trade in goods. The two markets are each other's main trading partners, with a share of 14.3% (US share of EU trade in goods, 2012) and 8.7% (EU share of US trade in goods, 2011). For the EU, the US is followed by China and Russia in second and third place, while the next two largest trading partners after the EU for the US are Canada and China.

The bilateral trade in goods totalled a half trillion euros (EUR 498 billion) in 2012. This figure has recently grown about 3.5% per year on average. The structure of the goods involved in foreign trade is heavily concentrated in machinery and transport equipment (40%), chemicals (22%), and other processed industrial products (12%). At EUR 110 billion, the bilateral trade in chemicals and medicine is even greater than the trade in cars (EUR 44 billion), which is also true in relative terms (24% of the chemical exports to the US vs. 20% for cars, and 27% and 16%, respectively, for imports). Beverages, tobacco products, foodstuffs, animals, oils and fats accounted for a total of 9% of trade, and agricultural products as defined by the WTO represent 4% of EU imports and 5.2% of exports (or EUR 23 billion in total).

The transatlantic trade in goods is predominantly of an intra-industry nature; the figures in this segment are very high.[11] This trade, in turn, plays a major role within companies in many industries (intra-group trade). It is estimated that this type of trade accounts for about one-third of total trade, and in some sectors, this figure is far higher. For example, the share of intra-group trade stands at 81% of Germany's automotive imports from the United States. For chemicals and pharmaceuticals, metal products, machinery, computers and electronics, the figures are also significantly higher than 50%.

The EU has surpluses in the trade in goods: in 2012 the figure was EUR 86 billion, of which Germany was responsible for EUR 36 billion. By sector, the EU records surpluses in foreign trade with machinery, automobiles and chemicals, whereas it has trade deficits in mining products, clothing, and office and telecom goods.

[11] Ifo Institute (2013).

Trade in services

US trade in services with the EU by industry 22

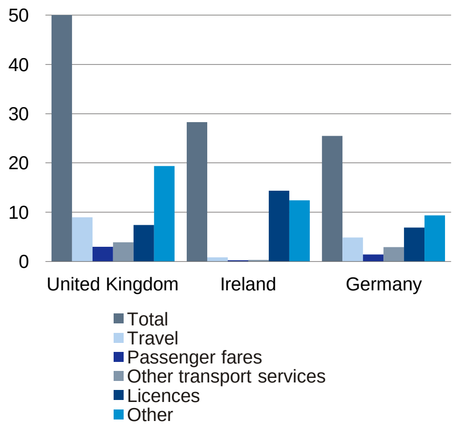
in USD bn, 2011	Revenues	Expenses
Transport	52.7	51.2
Tourism	38.5	32.7
Freight / ports	14.2	18.5
Licenses	48.9	18.6
Software	13.9	3.7
Industrial processes	19.6	11.7
Trademarks	4.9	2
Film and TV rights	7.6	0.2
Financial services	27	7.6
Insurance	3.5	12.9
Telecommunications	3.7	3.5
Computer and IT services	6.6	6.1
Consulting, advertising	15.8	11.4
Research and development	10.4	9.1
Industrial services	6.1	5.9
Total	*188.8*	*136.8*

Source: Bureau of Economic Analysis

The bilateral trade in services amounted to EUR 285 billion in 2011. The EU recorded a slight surplus (amounting to EUR 5 billion), as in most previous years. Although the 2008 crisis brought about a decline until 2009, trade has been expanding again since 2010.[12] The US accounts for 26% of service exports and 31% of imports of the EU. Unfortunately, a statistical breakdown by sector and partner country on the basis of balance of payments data is not available.

Exports of private services from the USA by partner country 23

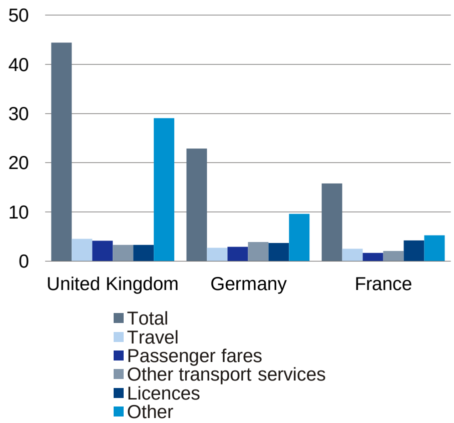
in USD bn



Source: Bureau of Economic Analysis

Imports of private services into the USA by partner country 24

in USD bn



Source: Bureau of Economic Analysis

Sales by subsidiaries between Europe and the USA, 2011 25

in USD bn	US subsidiaries to Europe*	European subsidiaries to USA*
Trade	142	72
Finance and Insurance	103	105
Finance	86	68
Insurance	17	38
Real estate	29	8
Business services**	89	48
Information services	90	46
Publishers	31	8
Audio-visual services	10	k.a.
Telecommunications	16	25
Internet	22	11
Industry	20	55
Other	105	101
Total	*576*	*435*

*Services sold to foreigners by subsidiaries of US companies by industry in the EU and services sold to the US by subsidiaries of European companies; all European countries
**Architecture, engineering services, computer systems, tax consultants and auditors, etc.
Source: Bureau of Economic Analsyis, International Services, Tab. 8-10

The US authorities also use surveys to track the trade in services. These surveys enable the trade in services between the US and the EU and its Member States to be broken down by sector. However, due to differing survey methods, these data cannot be compared with the balance of payments data. According to this information, trade in 2011 amounted to USD 325 billion.[13] The US has a trade surplus of over USD 50 billion, with exports amounting to USD 188.8 billion and imports of USD 136.8 billion. US exports of services to the EU are focused on the United Kingdom, Ireland (mainly licenses) and Germany, while imports are mainly from the United Kingdom, Germany and France. In addition to transport and travel services, there is brisk trade in consulting, advertising, research, finance and insurance services, and computer services across the Atlantic, especially between the US and the UK. The US has moderate surpluses in corporate and travel services as well as licensing income from software and film rentals. US companies generate large surpluses in financial services, but record significant deficits in insurance services.

A look at the provision of services by subsidiaries in the respective partner markets yields a similar picture. Here, too, the United States, with sales of USD 575 billion in Europe (including non-EU countries) in 2010, was well above European sales in the US of USD 434 billion. By sector, US sales in the EU in retail, real estate, and corporate and information services are significantly higher than sales by EU subsidiaries in the US, while the situation is reversed in other sectors. The US leads in banking, while the EU leads in insurers.

[12] These figures relate to the provision of services as captured by balance of payments statistics.
[13] All figures based on the service sector statistics of the Bureau of Economic Analysis for 2011.

Value added and knowledge

However, if an excessively schematic view of the trade in goods and services trade and investment is taken, one runs the risk of overlooking the internal connections between these variables. The OECD and the WTO have recently created a new database for trade, measured by gross value added. Although this has still not made a comprehensive analysis of the transatlantic economic relationship possible, the data on the value added share of services in exports do show in particular how intertwined modern production processes are today.[14] For example, services had a value added share of 58% of British exports in 2009, while the figure for France is 51%, the US is at 50% and Germany at 48%. Even 41% of German car exports are based on value added in the services sector. The value added attributable to foreign services amounted to 5.8% of exports in the EU-27 and 3.5% in the US. For comparison, services contribute just 29% to China's exports.[15] Due to the pronounced international division of labour in some sectors, trade and investment barriers place a much higher burden on costs in the end product overall than is apparent at first glance. If one also considers that in many sectors, production for the major regions of the world usually takes place close to the sales markets with very strong trade links to the company, it becomes clear how important the reduction of barriers to the efficiency of global value chains actually is.[16]

This interconnection of industrial products and services reflects the growing importance of intangible assets. According to the main indicators of the cost of acquisition of intellectual property rights (patents, trademarks, designs and utility models) and of success in this market, the US and the EU, together with Japan, continue to lead the world rankings. The rise of China and South Korea and other countries, however, is unmistakable, and Seoul and Shenzhen have joined the top ranks of global strongholds of knowledge.[17] Of course, given this competitive situation, the transatlantic efforts to maintain strong innovative power by better protecting intellectual property also play a major role.

Barriers and economic opportunities

Barriers to the trade in goods

Tariffs* 26

%	US	EU
Other	3.2	2.4
Wood and paper products	0.2	0.5
Metals and metal products	1.3	1.6
Other machinery	0.8	1.3
Other vehicles	0.2	1.3
Motor vehicles	1.2	8
Electrical machinery	0.3	0.6
Chemicals	1.2	2.3
Foodstuffs	3.3	14.6
Other main sectors	0	0
Agricultural, forestry and fisheries	3.7	3.7

* Trade-weighted, applied average tariffs, 2007
Source: CEPR 2013, p. 14

Despite the already intense transatlantic economic exchanges hurdles remain in all areas. For a good ten years there have been studies which have calculated the possible effects of liberalisation. They uniformly came to the conclusion that, despite the generally low level of barriers, the high level of economic exchange would ensure that a reciprocal opening of markets would produce very significant improvements in the standard of living, roughly in line with today's estimates.[18]

Tariffs continue to play a role in the trade in goods. The trade-weighted average tariffs in the trade in goods is already low at 2.1% for EU exports to the US and

[14] Own calculations based on the trade in value added database of the OECD and WTO, as at May 2013.
[15] See Hamilton und Quinlan (2013) on some of these phenomena.
[16] Balas (2013).
[17] See Rollwagen (2012).
[18] Vandenbussche et al. (2002) estimated the welfare effects in the EU at 0.7-0.9% in the static and at 1-2% in the dynamic perspective; for the US, the figures were 0.2% in the static and 0.5-1% in the dynamic perspective. The OECD (2005) estimated the income effects for the EU at 2-3% of GDP, and for the US at 1-2.5% of GDP. This would take place mainly through product market reforms in the two markets which would close the "best practices" gap in the OECD. Erixon and Bauer (2010) calculated the effects of a complete elimination of bilateral tariffs at almost half a percent for the EU and 1.3% for the US.

2.8% for imports of the EU (agriculture: 6% for imports into the EU and 1.3% for imports into the US)[19] and much of the trade is already tariff-free. The EU still imposes average tariffs of almost 15% on imported foodstuffs and for motor vehicles the figure is 8%, while tariff peaks no longer play a role in industrial imports into the United States. Tariff peaks do still exist in agricultural trade. In addition, strict quotas are applied to the import of certain products (e.g. beef). Tariffs are still a major cost factor in the automotive and chemical industries. In particular, in the intra-group trade in the automotive industry some companies occasionally pay high tariffs at several points in the process, including the parts trade and the sale to the end-consumer (such as US-made vehicles of European manufacturers, which are delivered to the end-customer in the EU).

However, the main obstacles are the non-tariff barriers, that is, regulation in the broad sense. Regulation refers to requirements for safety, health, environmental quality, consumer protection and other public interests.[20] Of course, these requirements cannot be completely eliminated, but about half of the barriers to the trade in goods and services could, in principle, be done away with, according to the most thorough and extensive study of EU-US economic relations[21]. This study also takes into account the tariff equivalents of non-tariff barriers in its estimate. On the European side, the average values for EU barriers to US exports in goods was 21.5% (and 25.4% the other direction) and around 9% in each direction in services.[22] The level of protection fluctuates greatly from industry to industry. The EU has set very high protective barriers (tariff equivalents of 20% and more) on food and beverages, motor vehicles, cosmetics and chemical products, while the US, in addition to these three sectors, where it has similar levels of protection to the EU, also provides substantial protection for office and telecommunications equipment. The tariffs for the aerospace industry, the textile and clothing industry, metal processing and medications are between 10% and 20%.

NTBs in agriculture 27

Tariff equivalents, in %	USA	EU
Alcoholic beverages and tobacco	13.6	64.1
Cattle, sheep, goats, horses	81.8	67.2
Grains	36.0	-
Dairy products	68.7	85.7
Groceries	53.9	56.9
Meat products	46.2	51.5
Oil sees	85.3	-
Processed rice	122.0	117.3
Vegetable oils and fats	6.0	74.3

Source: ifo Institute (2013)

In the enormous automotive industry, estimates put the cost of non-tariff barriers to trade and investment at a good quarter of the total cost. Nearly half of this could, in principle, be eliminated. There would be synergies in particular in product safety and environmental standards. In these areas, the hurdles consist mainly of the political deadlock between the EU-27 and the US in the relevant standard-setting bodies.

The second key industry in this regard is the chemical and pharmaceutical industry (including cosmetics). In this sector, the barriers to US exports to the EU are between 15% and 35%, depending on the sub-sector, and between 9% and 15% in the other direction. In particular, the divergent regulation of chemicals (REACH in the EU and the *Toxic Substances Control Act* in the US) have increased rather than reduced the barriers. In the cosmetics industry, the use of nanotechnology and the use of substances that have been tested on animals (or not) play an important role, with potentially diverging regulations. Different testing and approval procedures required by the high standards on both sides have brought about calls for mutual recognition in the pharmaceutical industry.

Trading costs of non-tariff barriers in the USA and the EU 28

Tariff equivalents in %	EU*	USA**
Chemical products	23.9	21.0
Medications	15.3	9.5
Cosmetics	34.6	32.4
Electronics	6.5	6.5
Office and telecom equipment	19.1	22.9
Automotive	25.5	26.8
Aerospace	18.8	19.1
Foodstuffs / beverages	56.8	73.3
Metals	11.9	17
Textiles and clothing	19.2	16.7
Wood and paper products	11.3	7.7
Average goods	*21.5*	*25.4*
Finance	11.3	31.7
Insurance	10.8	19.1
Business and computer services	14.9	3.9
Telecommunications	11.7	1.7
Average services	*8.5*	*8.9*

* EU barriers against US exports

** US barriers against EU exports

Source: Ecorys 2009

It is clear that in almost all sectors there is significant economic potential for cost reductions while still maintaining high standards of regulation, but this has failed

19 Information from the European Commission (2013c), Hufbauer, Schott and Wong (2010), CEPR (2013).
20 See also Büthe and Witte (2004), Stokes (2006) and DB Research (2007).
21 See Ecorys (2009), p. 16.
22 See Ecorys (2009) and the continuation of this work in CEPR (2013). According to an older study, the average tariff equivalents for all service sectors are at 6% in the US and 7% in the EU, see Hufbauer, Schott and Wong (2010). The ifo Institute (2013) uses a different methodology for both industry and services and arrives at much higher estimates. In particular, the chemical, paper and textile industries in the EU are considered to be extremely protected, while in the US, leather and machinery are the most protected.

due to political, administrative and regulatory incentive structures. While in the EU, for example, uniform standards of a quasi-public nature prevail, standard setting in the US follows a competitive and profit-oriented pattern without general public and international recognition of individual standards. In addition, there are legal aspects such as the different systems for product liability.

Barriers to the trade in services

In the trade in services, in turn, the regulations for market entry and the provision of services are generally not as extensive on average as in the trade in goods, but here, too, there is a very wide variation across industry sectors. In direct investment traditional barriers (ownership limits, licensing requirements, complete prohibition) continue to exist particularly in certain sensitive industries. The comprehensive study shows that US financial services have particularly high barriers, but most other industries receive only moderate protection, with tariff equivalents of less than 10%. On the European side, all business services (finance, insurance, communications and special business services) are protected with tariff equivalents of 10% to 15%.

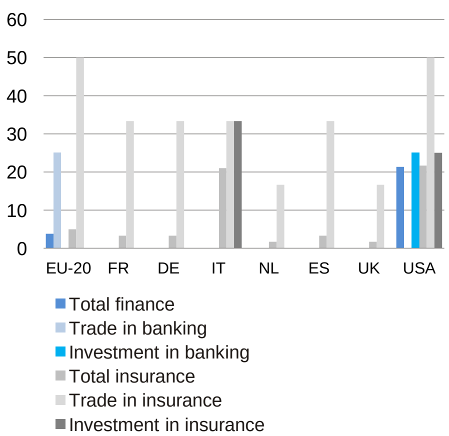
On the basis of an excellent new World Bank database, current barriers in services [23](as at the years 2011/11) also show strong industry-specific differences. Accordingly, the overall barriers differ significantly in the five vital service industries captured and in the largest economies in the EU and the US. Only in France does the telecommunications industry face hurdles, but this sector is otherwise very liberally structured. Traditional financial services (conventional bank deposit and lending services, and, in insurance, non-life, life and reinsurance business) are also relatively open. In retail, only Italy and France have barriers, and these are moderate. Trade and investment in transport services and the liberal professions, however, face medium to very high barriers on both sides.

Barriers* 29

	Finance	Tele-communication	Retail	Transport	Liberal professions
EU-20	4.2	0	25	37.1	54
France	1.3	12.5	25	43.9	46
Germany	1.3	0	0	24.4	59
Italy	8.4	0	25	32.8	58
Netherlands	0.6	0	0	18.9	39.5
Spain	1.3	0	0	30.6	45
UK	0.6	0	0	23.1	45
USA	21.4	0	0	7.9	54

* The index is on a cale of 0 to 100. Zero means free of barriers, 100 means completely closed.
Source: World Bank

Barriers to finance and insurance* 30



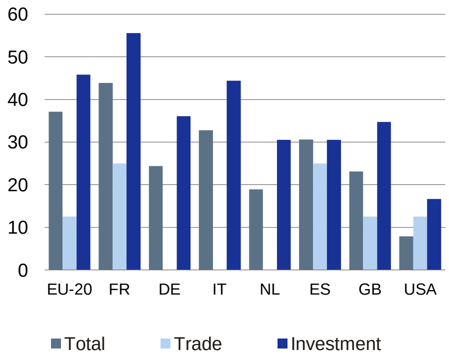
* The index is on a scale of 0 to 100. Zero means free of barriers, 100 means completely closed.

Source: World Bank

The crux in the individual sectors often lies in the details and in significant differences in the ways services are typically provided (particularly in cross-border trade, foreign branches, and sometimes in the provision of services by employees abroad).[24]

[23] This is the Service Trade Restrictions Database of the World Bank (http://iresearch.worldbank.org/servicestrade/home.htm), which was created in 2012, see Borchert, Gootiiz and Mattoo (2012a and b) in this regard.
[24] The General Agreement on Trade in Services (GATS) distinguishes between four different modes: In addition to the listed modes 1, 3 and 4, mode 2 (consumption abroad) is listed, which is mainly of importance for tourism. Tourism for its part is a very liberal industry, and is thus no longer a concern in the EU-US relationship.

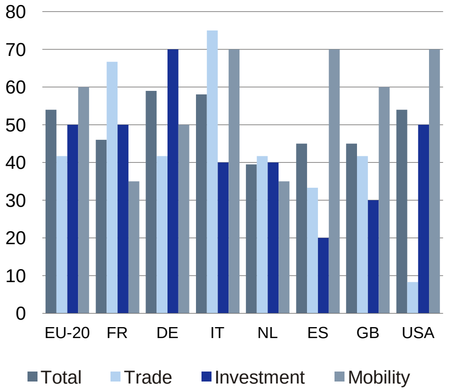
Barriers to transport services* 31



* The index is on a scale of 0 to 100. Zero means free of barriers, 100 means completely closed.

Source: World Bank

Barriers to the liberal professions* 32



* The index is on a scale of 0 to 100. Zero means free of barriers, 100 means completely closed.

Source: World Bank

Product market barriers, 2007 33

in %	US	EU-18*
Electricity	30.6	23.5
Construction	4.7	7.2
Distribution	22.4	27.6
Tourism	4.2	7.0
Transport	19.5	24.0
Post and telecommunication	19.2	20.9
Financial services	25.3	2.7
Real estate services	2.6	3.4
Machinery rental	17.0	25.7
Business services	14.9	25.0
Other	16.0	19.0

* Simple average not including Central European countries

Source: Messerlin and van der Marel, 2012

Below is a look at the individual sectors:

— The bank markets for deposits and lending are comparatively open in the large Member States and in the United States; there are moderate barriers to establishment at the state level.

— In the EU overall, the insurance market has average hurdles, and among the major markets, the United Kingdom and the Netherlands are much more open than Germany, France, Italy and Spain. The main sub-markets (automotive, life and reinsurance business) can usually only be reached through subsidiaries of US companies and are mostly subject to licensing and/or supervisory obligations. In the cross-border business the US market has average barriers (mode 1), with branch offices, however, there are only moderate barriers (mode 3). The individual states have different hurdles.

— In retail, France and Italy restrict the freedom of large businesses to establish branches subject to various requirements; all other countries considered provide unlimited market access.

— In transport services, the EU has an average degree of restrictions, while the US has only minor barriers. Branch hurdles are far stronger than border barriers. In the air transport sector (both domestic business and international flights) the branch hurdles in the US are very high, and in the EU they are high. France, Spain and Italy also have significant restrictions on international business. Except for the Netherlands, the majority of shares in airlines in the other large EU economies are usually held by EU owners, in some cases with higher rates of domestic ownership (Italy); in the US the restrictions are even tighter and foreigners are allowed to hold no more than a 25% share. The market for third country suppliers is completely restricted in the major EU countries in domestic road freight transport. France and Spain have also blocked third countries from rail freight, while Italy has sharp restrictions on them. Germany, France and the Netherlands also significantly restrict international navigation rights for third countries. Shipping related services (ports, maritime logistics, etc.), in contrast, are subject to only very limited restrictions on both sides.

— In professional services (accounting and auditing, legal services), there exist on both sides and across all forms of business medium and high hurdles, with peaks in France, Italy and the US.

Structures with a similar pattern of protection can also be seen in the product market indices of the OECD. In any case, significant differences remain at the national level in the EU, as the domestic market for services is still in its infancy. In the US, too, there are differences between the individual states.[25]

Barriers to direct investment

Even in direct investment, there are still a few, but significant, regulatory differences, which are expressed in implicit trading costs across the Atlantic. The US has particularly high hurdles in the aerospace, office equipment, chemicals, cosmetics and steel sectors, while the EU has high hurdles in biotechnology, aerospace, chemical products and cosmetics, office equipment and the textile and clothing industries.[26]

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[25] See Messerlin and van der Marel (2012).
[26] CEPR (2013), Chapter 6, and Ecorys (2009), p. 21 f.

Barriers to public procurement

Openness of the procurement market 34

	Market size (in bn EUR)	Legal obligations (in %)	Actual obligations* (in %)	
			EU	USA
EU	370	85	--	--
USA	559	32	46	47

*After deducting the EU's exemption regulations
Source: Messerlin 2013, p. 2

The further opening up of public procurement, along with trade and services, constitutes the third area in which mutual benefits can be achieved. Public procurement follows its own unique set of rules, to which the two central principles of the world trade order, national treatment and preferential treatment, apply only among the participating WTO members, for the goods and services covered by the regulation: the plurilateral agreement of 1994/95 on Government Procurement (GPA) under the World Trade Organisation. 42 WTO countries are now signatories to this agreement.[27] This agreement led to an improvement in market access conditions worldwide in March 2012. In the EU there is additional Community legislation on public procurement in the Member States. Public procurement accounts for about 15-20% of GDP on both sides.

The GPA obligations of the United States apply fully to goods, but only to a limited extent to services (exceptions for rail transport and buildings) from certain minimum amounts of public procurement. The obligations bind the federal government and 37 individual states, but not public companies or municipalities. In addition, some subordinate federal authorities are not covered. There is also a preferential system for domestic SMEs. Specific problems for international participation in contract work also resulted from the "Buy America" provisions, generally or as a result of special provisions in the US stimulus legislation of 2009, which extended to public buildings, investment in public transport and transport equipment for railways.[28] According to Commission estimates[29] the market volume subject to international obligations totals around EUR 556 billion in the US; European suppliers have de jure access to only about one-third (32%) of this market (EUR 178 billion), but de facto access to about half (47%). In certain sectors, European countries can only bid on projects via their US branch offices.

In the EU, goods are also completely subject to the plurilateral obligations, but services are only subject to them to a limited extent. Exceptions for the United States exist for water and energy supply, public transport, post, telecommunications and financial services, in which there may be a requirement that half of the services be provided by residents, but this probably occurs only rarely. In defence, the Member States are free to choose. Weak commitments exist in aerospace and in business and information services. In the EU, the market volume is about 16% of GDP or EUR 420 billion, of which approximately EUR 352 billion is subject to the GPA obligations. According to the Commission's estimates, US suppliers have de jure access to around 85% of the EU market that is subject to tender, while the de facto share stands at 46% (taking exceptions into account). At EUR 10-17 billion the EU's imports are as low as its exports (about EUR 10 billion).

This de facto balance in bilateral market opening goes back to 1995, the year the agreement was finalised, as the EU and the US agreed that each would have approximately USD 103 billion in market volume that falls under the agreement. In fact, the total imports of goods and services for the purposes of procurement increased from around 2.5% in 1995 to around 5% (2008) in both the EU and the US, with the EU half a point higher than the US and both ranked behind China (8%).

If barriers are reduced by half, the impact assessment of the research institutes considers small absolute increases in bilateral exports plausible (approximately EUR 14 billion for the EU and EUR 7 billion for the US), the income effects

27 WTO (2012a).
28 See Schwartz (2012), Linarelli (2012) and Ecorys (2009) on this topic.
29 European Commission (2012b, c), Messerlin (2013).

would be no more than EUR 12 billion or 0.05% (EU) of GDP and nearly EUR 7 billion or 0.03% (US).[30] Nevertheless, over the long term a significant increase in the intensity of the competition in this market might be possible.

Opportunities for liberalisation

In the preparation for the negotiations a number of studies have looked at the issue of what economic effects can be expected of certain scenarios for the liberalisation of economic exchange and market-opening regulation. Due to methodological differences there is no full agreement on the findings, but the main points can be noted as follows.

Moderate impetus for growth

Like the previous study, the CEPR study for the Commission considered several scenarios for the outcome of negotiations. In the analysis of a comprehensive agreement (in contrast to a tariff, NTB or services agreement[31]) a distinction is made between a moderate and an ambitious result: in the moderate case, 98% of tariffs are abolished, 10% of non-tariff barriers to trade in goods and services eliminated and the procurement market opened by a quarter more; in the ambitious case, all tariffs, a quarter of the barriers to goods and services, and half of the barriers in procurement are eliminated. The following effect estimates relate to effects through 2027 and are described for the two sub-scenarios as follows:

Growth: Economic output (GDP) would increase by EUR 68-120 billion (0.27%-0.48%) in the EU and around EUR 50-95 billion (0.21 to 0.39%) in the US. This represents a level shift over several years.

Bilateral trade is growing strongly

Trade: EU exports to the US would increase by 16-28% (EUR 108-189 billion), and imports from the US would rise by 28-37% (EUR 101-159 billion). Two-thirds of the effect would result from the reduction of non-tariff barriers to the trade in goods. The foreign trade of both regions would increase by a total of 3-6% in the EU and by 5-8% in the US. The EU's exports to other third countries would be expected to increase by EUR 33 billion, while imports would increase by EUR 67 billion. The trade diversion to third countries would be around EUR 72 billion, half of which would be accounted for by the automotive industry alone. However, if one takes into account the fact that the EU is also negotiating preferential agreements with numerous other third countries, these figures may represent the upper range. The EU tariff revenue would be 6-8% (EUR 5-6 billion) below a status quo scenario in 2027 (benchmark for all tariff revenue: EUR 79 billion).

Sector effects: EU exports of vehicles, chemicals, foodstuffs and insurance services are likely to increase significantly, while electrical equipment would be expected to decline. For the US, electrical equipment, aerospace products, metals, chemicals and telecommunications services would be the beneficiaries of an agreement. There would generally be little change in manufacturing. The only change worth noting would be a drop in the manufacture of electric machinery by 4-7% in the EU and a decline in automobile production in the US by 0.6-2.8%.

Income: The disposable income of private households in the EU would probably increase by EUR 40-71 billion, and by EUR 30-59 billion in the US. This corresponds to an increase of an average of EUR 545 for a four-member EU household and of EUR 655 for a US household of that size.

Wages and employment are rising

Wages and employment: The impact on wages for both sides is positive, and in the long term (calculated through 2027) would be about half a percentage point

[30] CEPR (2013), Ecorys (2009), p. 183 ff.
[31] I will not go into greater detail on this case as the EU and the US have already agreed to pursue a comprehensive agreement.

for the EU and nearly 0.4% for the US for both low-skilled and highly-skilled workers. The main beneficiaries are mostly medium-sized companies and their employees, whose average labour productivity and wages would increase. In the longer term there will be increased employment on both sides, on balance, with structural shifts of up to about 1% per sector taking place in the scenarios used by the Commission.[32] Estimates also show that wages are expected to increase slightly for both low-skilled and highly-skilled workers. According to the estimates, jobs would be lost in the US automotive industry and the EU electronics industry jobs, but the number of jobs lost would be minor. In the sophisticated modelling of the ifo Institute, depending on the scope, employment effects are estimated at 18,000 (tariffs only), 193,000 (elimination of NTBs) and at almost 500,000 (internal market scenario) additional jobs.[33]

Effects on third countries largely positive

International impact: it would be virtually impossible to estimate the effects of an agreement on third countries without a detailed review of the parallel processes of other preferential agreements of the US and the EU. In the pure model view and under the assumption that progress in the convergence in the standard-setting and regulation between the transatlantic partners would also have a positive effect on third countries, the transatlantic agreement would have positive effects on welfare in third countries; surprisingly, this is true in particular for the very open ASEAN countries.

The road to the agreement

Preliminary negotiations

Very broad agenda of issues has been agreed

The report submitted on 14 February 2013 to the High Level Working Group on Jobs and Growth recommended negotiations on a very wide range of barriers to transatlantic economic exchange. The treatment of individual disputed issues is not at all clear, but the field is still wide open.

Both sides want to reduce or eliminate tariffs, quotas and technical barriers to the trade in goods. In order to accomplish this, ambitious agreements on technical barriers to trade and sanitary and phytosanitary trade regulations should be concluded which go beyond the WTO agreements on these issues. All barriers, whether they are at the border or involve internal regulations, in the services sector and in mutual investment activities should be reduced or abolished. The opening up of public procurement should be expedited. In addition, general disciplines on regulatory cooperation should be established and sector-specific agreements on harmonisation, mutual recognition and similar mechanisms should be concluded. Provision is also made for a general agreement on investment. Regulations on trade or investment-related aspects of environmental protection and workers' rights, rules on competition and on the bilateral settlement of disputes should be created. In a further step, common rules for economic exchange with third countries should also be developed. This includes the critical issues of energy and commodities, the subsidy practice in state-owned enterprises, better protection of intellectual property rights, customs procedures and trade facilitation, the special needs of medium-sized companies, issues of capital movement and rules to combat corruption.

In the preparations for the negotiations being made by both sides, there have been important substantive debates in the EU between Member States on the exact mandate for the European Commission and in the United States between trade representatives and other units of the Administration on the one hand and

[32] CEPR (2012).
[33] Ifo (2013).

the US Congress, which established the usual 90-day consultation period for first hearings. In this process, two issues predominated at the European level: audiovisual services and financial services. While France insists on excluding audiovisual services from any negotiations with regard to the maintenance of national broadcasting quotas and state subsidies for EU-produced films and programmes, which have been in place since the Uruguay Round, the US called for there to be no exceptions in this sector. In return, the EU prefers the negotiation to include discussions of regulatory issues in financial markets, while the US wishes to speak only about market access issues beyond any regulations.

A look at selected issues

However, there are serious differences in the economic importance of many issues that are mentioned in the final report of the expert group. The battle must be won in two to three key areas; many other areas, however, are only of ancillary economic importance.

Elimination of technical barriers to trade in manufacturing

The main hurdles are differences in regulation

The elimination of technical barriers is the greatest challenge in the negotiations. Without a significant reduction of these barriers, the desired macroeconomic effects will be impossible to achieve because this area would contribute around half of the total economic benefit. The objectives mentioned by the HLWG are greater openness, transparency and convergence of regulatory approaches and requirements, as well as standard-setting processes, a greater confidence in the inspection authorities and better global cooperation. Achieving these aims will not be easy, despite very similar regulatory objectives and methods in most industries, as different institutional contexts (e.g. public or for-profit institutions in standard-setting), programmed conflicts between the political players involved in trade and regulation and decades-old conflicts between governments must be overcome. However, efforts are being driven by the joint concern that standard-setting power could be increasingly lost to China, and cooperation is the only way the two sides can continue to assert their market power and preserve their mutual economic interests worldwide.

For forty years there have been efforts to achieve convergence and transparency

A look at the history sharpens the judgement of the current opportunities and risks in this field. In the transatlantic relationship four major phases of closer cooperation in product market regulation and technical standards have been completed without the sweeping success that is now sought. There was a focus on these issues as early as the Tokyo Round of GATT (1973-1979). The agreement on technical barriers to trade (TBT) established rules and procedures for transparent and intensive cooperation. In the application, however, there was a failure in key industries to fulfil the spirit of the agreement, because even then the domestic regulatory authorities and private standard-setters were putting up a successful defence against the simplification of economic life sought by businesses and trade policymakers. Even the postponement of the debate on trade barriers in dispute settlement mechanisms was no help.[34] There was no shortage of dialogue with business. The business community had been involved in intensive discussions from the start. For example, the US government sought advice from 27 industry committees, and the Commission led the formation of Community business interest groups in the form of European federations of industry and agriculture. Nevertheless, in hindsight the European side was dissatisfied with the agreement as, without the effective involvement of private organisations, it had failed to create corresponding regulations to resolve the fundamental inequality of the binding force of standard-setting and conformity

[34] See Winham (1986) and Grieco (1990) on this episode.

The systems vary considerably

inspections (inspection, testing and certification procedures) with the wide-ranging, strict application of public law and the full integration in the EU and only partial integration of US institutions.[35] In the thirty years since then, the situation has probably deteriorated steadily because of the divergent processes, with one major exception: comprehensive mutual recognition is practiced in the aerospace industry. In the Uruguay Round, in turn, the focus was on other issues, such as anti-dumping rules, the SPS standard (see agriculture below) and the General Agreement on Trade in Services (GATS) and the vague provisions it contains on exemptions from the basic principles of non-discriminatory trade in the event of regulation in the public interest.[36] There have also been negotiations on this issue in the Doha round, thus far without result.

Bilateral approaches have been pursued since 1995

Given the unsatisfactory situation, there were also further efforts on the part of the EU and the US to counter the negative trend. In a second phase, after the general agreement on a "New Transatlantic Agenda 1995" efforts were made in the nineties to find a way out of the impasse by concluding agreements for the mutual recognition of procedures for conformity assessments. After four years of hard negotiation, an agreement was reached in 1998 for mutual recognition in six industries (medical equipment, medications, sports and recreation equipment, telecommunications equipment, computers and electrical equipment). This accounted for a trading volume of approximately USD 50 billion. The actual standard-setting, however, was unaffected by the agreement. Instead, companies now had the choice between public (US) or public or private (EU) approval authorities. However, the implementation caused difficulties, and tensions between trade policy and regulation remained.[37] However, the business community was organised during the process through the establishment of the *Transatlantic Business Dialogue* (TABD).

Principles and processes for cooperation have been existence for a long time

A third attempt was made in 1998 with the agreement on the transatlantic partnership, which was supplemented in 2002 by an agreement on regulatory cooperation. Both sides then raised the ante in 2004 with an agreement on the recognition of ship safety equipment. This phase ended with no major concrete results, though it did help to set the basic course for future action.

TEC did not deliver the expected breakthrough

The fourth attempt was then made in 2007 with the Transatlantic Economic Council and the high-level forum for regulatory cooperation. Despite some progress and general agreements on principles of regulatory cooperation, however, there was no breakthrough to a large-scale opening of the markets.[38] In any case, it should be emphasised that there is cooperation in regulations being created for entirely new products and technologies (nanotechnology, electromobility), with the early goal of joint standard-setting, but the number of major differences in the industries involved in this trade generally continued to grow. In addition, since the outbreak of the crisis, an intransparent sort of protectionism has increased significantly, with a clear increase in technical barriers to trade and SPS measures in both the EU and the US.[39]

Highly differentiated but radical process needed to achieve overall economic benefits

The lessons of the past clearly indicate that only a comprehensive approach involving all relevant players with a sector-specific strategy and very precise selection of instruments can make significant progress possible in the entire process of standard-setting and product approval. The business associations and some industry associations of both regions have submitted proposals regarding the principles and procedural steps that would allow the trend to be reversed. So far, concrete timetables for the mutual recognition of central

[35] See Grieco (1990), p. 182-186.
[36] Croome (1995), p. 48-52, 188-194, 280, 297-298, 331 f. and 351-355.
[37] See the detailed case study in Devreaux, Lawrence and Watkins (2006) in this regard.
[38] See TEC (2010a, b, c) and Mildner and Schmucker (2011). There were a number of bilateral solutions on other issues in the TEC, such as safety regulations for trade in goods, IT solutions in healthcare and the protection of intellectual property rights in third countries.
[39] Evenett (2012) and WTO (2012b).

standards have been presented by the automotive industry. The mutual recognition of standards and conformity inspections could produce a breakthrough in this industry, which would have especially significant economic effects. In chemicals, this is not considered directly possible, but the focus is on better cooperation and shared scientific assessment. In the chemicals and pharmaceutical industry, the main focus will be on more efficient methods of regulatory cooperation, which has been attempted without much success since 1990. For new products and processes, common rules could also be worked out on the basis of the TEC's efforts. In the pharmaceutical industry, in turn, the key lies in the regulations of the drug approvals, where both sides have high standards, but incompatible rules. There are many arguments in favour of the mutual recognition of approvals in this area. Things are more difficult in electrical engineering and mechanical engineering, and in the past there has been insufficient courage to bring about mutual recognition of product safety standards.[40] If the Atlantic partners succeed in negotiating an ambitious additional chapter of the TBT, this could have broad spillover effects on WTO regulations and permanently change the current practice of regulatory cooperation in this absolutely essential area of world trade.

Horizontal rules and sector agreements must go hand-in-hand

It is not expected that all the tasks in this area can be completed on the first attempt. Rather, it will probably come down to a horizontal framework for regulatory cooperation in conjunction with sector-specific annexes, together with detailed task plans for the near future. The risk of this architecture of a T-TIP agreement is naturally that, in many cases, a breakthrough can only be achieved with an extremely high level of political support. If such an agreement is concluded with genuine liberalisation not having been agreed, but only announced, there is the risk not only that parliaments on both sides will fail to ratify it, but that this opportunity to create jobs and economic growth will have been squandered. On the other hand, if the intention is to achieve real success, including in the short term, several Gordian knots in the triangular relationship of governments, regulators and regulated industries must be overcome at the beginning. The negotiators on both sides are well aware of the situation, but whether the downstream and partially independent regulatory institutions in particular can be persuaded to come along for the ride is the crucial question that could make or break T-TIP.

The problems of technical requirements have been on the back burner for a long time

Trade in agricultural goods and foodstuffs

Conflicts in agricultural trade should be bought into calmer waters

The negotiations on tariffs, quotas, and public health standards (in WTO parlance sanitary and phytosanitary standards or SPS) in agricultural trade are likely to be of much less economic importance but even greater political significance. As with the trade in goods, both sides are aiming for a substantial reduction of tariffs and quotas, with different requirements for sensitive products in terms of timing and quantities and, in particular, better procedures for regulatory cooperation, with multilateral rules and procedures which go beyond those in the WTO and other international organisations ("SPS-Plus"). In recent decades the Europeans in particular have implemented health policy provisions that created barriers to imports from the United States in certain product categories (chicken, beef, genetically modified foods, wheat, feed) and using the rhetoric of the "precautionary principle", which the US refutes, often citing insufficient scientific justification and risk-based application. But the US also maintains long lists of blocked exports to the EU and has occasionally imposed long-term public health restrictions on imports from the EU ("BSE cows", apples and peaches suspected of having pests). Highly complicated negotiations and dispute settlement procedures are straining relations, and even the three disputes settled in the WTO in the US's favour have not brought about a

[40] See examples in TBC (2013) and AAPC and ACEA (2013).

permanent change in behaviour in the EU. In addition, in the EU there is often dissonance between the competent authority and the European Commission on the one side, and the Council and the European Parliament on the other side. Without a positive vote by all these institutions, the market remains closed.

Health standards in agricultural trade helped to build trust

Since the conclusion of the Uruguay Round of GATT there has been a multilateral legal framework for SPS, of which vigorous use is made. The regulatory framework establishes a degree of transparency for the wide range of protective measures.[41] A breakthrough to a better procedure in the transatlantic relationship could, in turn, have a very positive impact on the WTO. Interestingly, it was precisely this area that had been selected during the test phase of the efforts of the High Level Working Group on confidence-building measures on both sides; and there was actually movement on both sides on these contentious issues.[42]

Tariffs, quotas and geographical indications provide opportunities

In matters of tariff and quota cuts, both sides will have to put the especially highly concentrated interests of producers (beef and chicken on the EU side, sugar and dairy product manufacturers on the US side) in their place. These problems can typically be solved by a gradual procedure and the expansion of tariff quotas during the transition to the complete abolition of restrictions, but the desire of producer groups to avoid the discipline of an agreement creates constant problems for negotiators. In addition, negotiators will have to address the issue of how the issue of improved protection for *geographical indications*, (GIs), e.g. Parma ham, brought forward by the EU for agricultural products with similar levels of GI protection as for wines and alcoholic beverages such as the TRIPS agreement to protect intellectual property in the WTO. The US prefers the protection of generic product names such as mozzarella, and resists strong legal GI provisions to satisfy US export interests. It is possible that a compromise involving the two product lists can be negotiated.[43]

Political significance is central

No agreement without the opening of agricultural markets

Politically, the issue is tricky, since agricultural interests are overrepresented in the US Senate, which must ultimately decide by a two-thirds majority on the agreement. On a recent trip to Europe, Senator Max Baucus, a Democrat from Montana and current chairman of the Senate Finance Committee, also left no doubt that without a substantial opening of the EU agricultural market no agreement will pass the Senate. But the European side will also not have an easy job convincing Member States with strong protection or export interests and committees of the European Parliament or national parliaments of Member States which are responsible for SPS issues to take a new line. The Uruguay Round showed that transatlantic agricultural disputes are extremely tough to settle even in extremely small product segments and that they can only be resolved at the highest level.[44] President Obama and the President of the Commission and the Council and the Heads of State or Government of at least Germany and France are highly unlikely to be spared a debate on the regulation of beef and cheese at their joint dinners where these very products are served.

Services

The trade in services is subject to very complex regulation

The opening of services markets to providers from other countries is still a relatively young field. Even within the EU, despite the internal market for services, which has, in principle, applied since 1958, some areas are still in a sad state. Across the Atlantic, the first comprehensive set of rules was launched

41 Croome (1995).
42 The EU has committed itself to review the barriers to the import of lactose-treated beef, the disease status of live pigs and the use of animal fats for bio-fuel production, while the US will review the barriers for apples and peaches (pest status) and cows ("BSE" - areas of origin), see Schott (2013).
43 See Schott (2013).
44 Deutsch (1999).

with the Uruguay Round of GATT 1994 in the GATS. Several industry agreements were concluded in the late nineties in this context. Although the originally planned "built-in agenda" of liberalisation (GATS 2000) resulted in the Doha Round of the WTO, it has thus far not gone beyond the "signalling" of possible liberalisation measures in 2008. Nevertheless, the WTO grouping of "Really Good Friends of Services" has used this as the basis to initiate plurilateral negotiations on an agreement on the trade in services in 2013.

In some sectors, the level of protection is still very high

While agreements have been concluded in the bilateral relationship between the EU and the US in sectors like aviation, sectors that had been excluded by both sides – not from the basic rules, but from opening – in the negotiations on GATS 1994 remained largely protected. On the US side this concerns in particular marine and aviation rights on routes within the US, and on the EU side, the audiovisual services and on both sides the liberal professions. No real rules have been created so far for the new data services. And in the area of financial services, regulatory initiatives and their implementation in the G20 framework have created new barriers primarily in the United States.

The High Level Group has agreed to aim to attain the highest level reached in other bilateral agreements. For both sides, this level may have been reached in the agreement with South Korea. An approach could easily be taken in which a negative list for national treatment could be linked with a positive list of industry commitments. After all, the EU has already worked with negative lists in the negotiations with Canada. The EU will have to undertake to get commitments at both levels: community law and national law.

Further openings in transport services and liberal professions conceivable

In the area of transport services, there is much to be said for the breaking down most of the old barriers to market access. To accomplish this, some very old laws in the US, such as the Jones Act in the area of navigation, which prohibits foreigners from transporting cargo on the US coast, will have to be modified, and some European countries will also require legislative changes. It may also be necessary to agree on similar rules in the field of aviation, which was excluded from the GATS provisions. Access to public contracts will also provide opportunities in this area. Numerous access barriers could be reduced in the regulated professions. At the request of France audiovisual services were initially excluded in the EU's mandate from a first discussion of the issue in the negotiations, although the European Commission has reserved the right to reach out to the Council again at a later point with an appropriate mandate proposal. The question of exactly how financial services are to be negotiated was still open at the time this study was being prepared. In this area the EU is seeking to reach an agreement on fundamental issues of regulatory cooperation.

Very demanding rules are needed for big data

The most critical point in bilateral relations concerns new Internet services, mainly of young US companies. No real, set multilateral legal framework exists for these new activities[45], and many of these activities may well be affected by the trilogue negotiations in the EU on the proposed EU data protection legislation. The EU is revising its data protection legislation, which has been in force since 1995, and is seeking to finalise the revisions by the end of the current legislative period in June 2014.

The EU has thus far not considered US legislation on data protection to be adequate for mutual recognition, although the US has a variety of special federal and state-level data protection laws. However, the EU has concluded a number of special agreements (exchange of passenger data and bank account information in the service of terrorism) with the US. However, the most important framework agreement is the "safe harbor" agreement of voluntary certification of compliance

[45] These include the "Internet of Things" ("Industry 4.0"), the offer of "clouds", intelligence services, integrated systems for consumer data analysis ("big data"), customised Internet-based promotions in conjunction with retailers, social media services and many other new services.

with EU data protection law by US companies, which has been in force since 2000. The method includes private and public enforcement mechanisms[46] but the US authorities complain that US companies have been repeatedly excluded from transactions with EU customers with reference to possible deficiencies in data protection. In addition, the drafting of the new data protection regulation in the EU has set off a wave of lobbying activities by Internet service providers whose business model is based on the processing of global customer data, for whom a stricter legal framework in the EU would have far-reaching consequences. Incompatible rules and concerns on one or other side of the Atlantic that, for reasons of public access with regard to national security, lack of protection against third-party access, or the lack of compliance with safeguards for personal data, company data would not be permitted to be transferred to or stored in partner regions not only affect Internet service providers, but also a variety of other business sectors. A global framework for the Internet economy is obviously lacking, and in the transatlantic relationship a risk-appropriate and differentiated approach to protection in this new world will have to be found. Organisations on both sides have long hoped for an "interoperable" data protection law with high standards along the lines of the OECD principles on data protection. In fact, the problem lies less in the question whether jurisdictions have data protection laws in place, which they generally do, and more in what regulations they use to implement this. The different rules are already creating considerable difficulties for legal subjects in practice.

The political fact that the basic regulation is to be negotiated in the current EU legislative period without being a formal subject of T-TIP adds to the difficulties. Conflicts about the scope of intelligence activities aggravate the situation. If there is an issue where the T-TIP talks could ultimately fail, this is it.

Other issues

Investment protection should regulated

Many of the other issues will not play a prominent role in the negotiations in terms of their economic potential. The regulations being pursued are more important for the management of relations after the entry into force of the agreement and to relations with third countries. For example, provisions include an agreement on a bilateral framework for investment, which, together with the protection of investments, will govern some issues of market access.
This raises a whole range of new structural questions, because so far there are few agreements on this in bilateral relations, mainly the United States with some Eastern European countries, since in general the protection of investments in the ordinary legal system has been considered sufficient.[47] A general market opening is not required, and industry-specific barriers can also be eliminated in the individual sectors. It will also be important to determine which dispute settlement mechanism should apply. Moreover, efforts are being made to achieve greater openness to competition in the area of public procurement. The past shows that the focus here will be on very specific reciprocity and the scope of the commitments will, accordingly, be expanded incrementally and a balance will be maintained. Both sides also stressed the importance of having stricter rules for third countries. The extent to which bilateral rules about, for example, how to deal with subsidy practices or the "localisation duties" of third countries can have effects on these third countries, too, without also being anchored in WTO rules, is another matter. These fields are usually governed by weak WTO rules that must be adhered to if agreements are to be binding.

Procurement markets may be opened further

[46] See information http://export.gov/safeharbor/eu/eg_main_018494.asp in this regard.
[47] See Mair and Mildner (2013).

Trade policy evaluation of the project

Multilateral diplomacy is faltering, but the multilateral order is on a firm foundation

The rise of China, South Korea and individual ASEAN countries in world trade and investment events of the last two decades, in particular with China's (and recently Russia's) entry into the WTO, has strengthened the geographical scope of the multilateral trading system. In addition, the major trading nations make intensive use of the dispute settlement mechanism, even and especially in bilateral relations with China. At the same time, in the past decade the Member States of the WTO have failed to open markets further multilaterally and to take full account of the urgent need to adapt the rules to the realities of today's economic relations. This has been due primarily to diverging interests between China and the US on mutual obligations. This has led to a shift in actual trade policy activity to a variety of preferential agreements, to new plurilateral activities, such as the strengthening of the agreement on government procurement and new negotiations on a plurilateral agreement on services, and increased regional trade integration in Asia.[48]

Trading strategies in East Asia are very complex

In addition to preferential strategies in the EU and US that are based on modern regulations, above all East Asian integration will be crucial to the further development of the world trading system. South Korea is positioning itself as a service and trade hub in the East Asian wheel, and is quite explicitly pursuing a multi-pronged strategy of developing economic relations with the EU, the US, Japan and China. Separate regulations applying just to Asia do not fit in this plan. Japan, in turn, is urgently seeking to keep pace with the new conditions and has opened up its markets to the Old World in TTP and EU-Japan negotiations. A de jure or de facto focus on China and Asia is not in the interest of Japan in light of the global activities of Japanese companies.

China’s potential is giving a boost to diplomacy

The future of the world trading system thus depends on China's foreign economic policy. While there have been conflicts in the multilateral trading system, mainly because of China's economic system, China has not been tempted thus far to go its own way in the areas of standard-setting and regulation in key industries. The sensitivity with which the US and the EU are responding to the challenge in the area of electric mobility shows how great the potential is, especially in the new technologies in which China could develop technological leadership and market power. At present, this is thought to be likely to occur in a very limited number of fields over the next one to two decades, because Chinese companies are technology leaders in very few fields. In the longer term, however, this will obviously happen more frequently.

There is no simple way to multilateralise the T-TIP agreement

At present, one can only speculate about the intriguing question of whether the development of regulations in the TPP and T-TIP in a second round might lead to a subsequent multilateralisation in the World Trade Organisation and in other international organisations. This depends mainly on how the major exporters that are not included in the agreements view the opportunities and risks of such an approach. In addition, many poorer WTO members are likely to have difficulty in implementing the complicated rules and standards without further ado. In many individual cases, the blockades in the WTO are based mainly on completely different development priorities. This suggests that new solutions in a bilateral relationship between the EU and the US (or in TPP) should be anchored only in highly complex negotiations and only to a lesser extent in the world trading system. For companies, this will likely mean that the rules for cross-border trade, direct investment and other business activities across borders will become steadily more demanding and will at the same time differ by region. On the other hand, a focus of multilateral trade policy on Chinese needs and problems would be politically difficult to justify, although this is where the

[48] See Hansakul (2013) in particular on the ASEAN Economic Community.

biggest tasks in trade policy are to be found. The world trading system is in a political dilemma, and a swift end to this imbalance is not in sight.

Political prospects

Navigation is key: Economic opportunities exist

The prospects for an ambitious partnership agreement between the EU and the US are better than ever. Governments and parliaments of both parties largely support the objectives and corporate interest groups are involved broadly in the political processes. The basic decision to address persistent barriers in order to deepen integration has already been taken, despite massive scepticism on both sides as to whether problems that have been disputed for decades with no real solution can ever be solved. However, a conclusive solution to all these problems is also not necessary. The lion's share of the economic opportunities can be realised by making changes in certain industries that are not especially politically difficult, usually without having to amend legislation in any respect. In principle, the personal commitment of the political leadership should be sufficient to break through bureaucratic-institutional blockages and, where necessary, the underlying narrowly-defined business interests. Naturally the negotiators have yet to achieve this breakthrough.

Tough nuts will have to be cracked in agricultural trade and in the area of data

However, barriers based on very deep political and cultural differences or that can be easily politicised on that basis remain difficult. Food security issues thus play such a sensitive role in public opinion that rational approaches to the reduction of traditional protectionist measures in the area of agricultural trade are always very risky domestically and can fail in the parliaments of both sides. Particularly serious, however, are very different ideas about the standards of data protection in the new Internet services. Although the difference in regulations is less than sometimes perceived, cultural discomfort on the European side at the business-like access to personal data is countered by an innovation-friendly and far less anxious attitude on the US side. Leading US politicians have made it clear that an innovation-friendly regulation that will help shape the future of the Internet is the main concern of the US, while EU leaders seek to anchor data protection standards, which are based on the high German standards, in the new EU basic regulation. Ultimately, T-TIP can only succeed if a truly resilient solution to this issue is found.

Very generally, the negotiations through to the agreement between the negotiators is only the first hurdle the agreement will face. It will then have to be ratified by the US Senate by a two-thirds majority, the European Parliament by a simple majority and by all 28 parliaments of the Member States of the EU-28, as it has been decided that this is a mixed agreement with the EU bearing the majority of the responsibility and the Member States partial responsibility.

The speed is vital: The goal of 2014 is very ambitious

It is generally felt that the negotiators on both sides will do everything they can to complete the agreement by autumn 2014. The political winds are currently favourable, and if headwinds should appear from unexpected directions, major projects may end up being shelved for some time. The fate of the WTO's "Doha Development Agenda" serves everyone as a warning.

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