

# The blockbuster free trade agreement

BY MORENO ZANI

The proposed Transatlantic Trade and Investment Partnership between the US and Europe will be huge. But along with the opportunities it affords there will also be risks. Many industries will need to adapt.

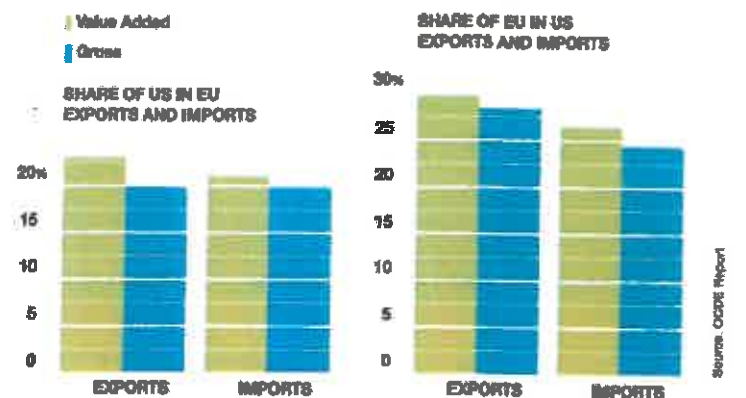
Vane Brothers Co. crew members dock a barrel oil barge next to a container ship in Newark Bay in Elizabeth, New Jersey, October 1, 2013.

In the summer of 2013, the Organization for Economic Co-operation and Development (OECD) published a working paper on the trade relations between Europe and the United States in order to foster the "Transatlantic Trade and Investment Partnership" (TTIP). On February 13, 2013, the European Union and the US announced their intention to sign the biggest bilateral free trade deal ever negotiated. The aim is to expand on a series of previously ratified agreements concerning international trade and investment flows, which should assist both economies to stimulate growth and job creation. The agreement, which is currently being negotiated, foresees the elimination of tariffs, the reduction of barriers to foreign investments, the liberalization of certain sectors and industries, and the harmonization of technical regulations, standards, and approval processes. Should this agreement be signed, it would represent the most important bilateral agreement in history and would create the largest free trade market in the world, covering almost 50% of world GDP and accounting for 30% of world trade and almost 20% of foreign direct investments.

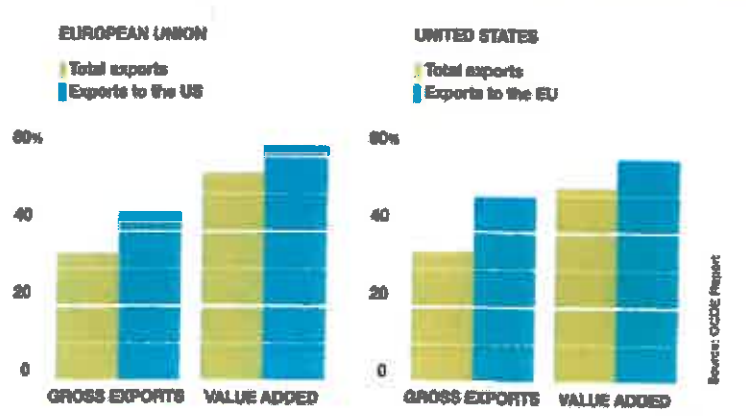
The US and Europe are respectively each other's largest commercial trading and investment counterparts. In 2012, the EU accounted for 63% of US foreign direct investment and 44% of foreign direct investment in the US was from the EU. Bilateral investments between these two big economic blocs have so far generated a fifth of the total mergers and acquisitions activity. In terms of imports and exports, the US accounts for 20% of European exports and imports (excluding intra EU trade) while the EU accounts for 28% of US exports and 24% of imports. If we refine the



TABLE 11. SHARE OF GROSS AND VALUE ADDED TERMS AS A PERCENTAGE OF TOTAL EXPORTS AND IMPORTS, 2009



SERVICES AS A SHARE OF GROSS EXPORTS AND VALUE ADDED EXPORTS, 2009



search to high valued-added products, the flows are even more significant.

Observing the trade of high value-added goods, it is also important to note the relative weighting of services, underestimated until now, which account for approximately a third of the total exports of the EU and the US.

The share of services in US and EU high value-added exports increases to 52% and 56% respectively. Furthermore, the share of services in the value-added commerce between the US and the EU is greater than that between other trading partners: in fact, it represents 63% of the EU bilateral exports and 61% of the US bilateral exports.

This data fully supports an ambitious program, in line with the objectives proclaimed by the parties last February to improve the efficiency (costs) throughout the entire value chain.

The key potential benefits are several:

**On tariffs:** the goal is to remove as many of the remaining duties as possible on agricultural and industrial products, even though it has already been decided that the more sensitive products will receive "special treatment."

**In services and investments:** the goal is to integrate as much as possible the existing trade agreements. It will look to open up and liberalize certain industries and services, among which the transport sector.

**For public procurement contracts:** the objective is to continue the liberalization of the market at all levels of government.

**Non-tariff barriers:** the aim is to eliminate all measures that create unnecessary costs and delays to commerce through the introduction of a mutually recognized set of regulations and procedures (standards). The negotiations will have to tackle regulatory compatibility and harmonization in key sectors such as chemicals, automotive, and pharmaceutical, and on patents and intellectual property.

**In the agricultural sector:** substantial benefits could be made if the protectionist barriers could be reduced or eliminated completely.

**Social and environmental aspects of trade:** the search for common solutions, starting from what has already been developed in the existing trade agreements between the two blocs.

Given that the traditional trade barriers between the US and EU are already low, studies suggest that most of the benefits from any trade agreement will derive from the easing of "commercial obstacles."

A previous working paper of the OECD estimates that the potential gains for the EU and US could be around 3% to 3.5% of GDP. Other studies conclude that the EU's GDP could increase by between 0.5% and 3.5%, while yet others estimate a 13% GDP growth for the US and a 5% growth for the EU. With both economies requiring fiscal consolidation and a reduction in unemployment, this agreement could usher in significant steps forward. It remains difficult to estimate precisely the potential dynamic effects of trade, investments and the resulting productivity growth.

One of the more likely effects could be an internal change in the value chain rather than the re-allocation of entire sectors. The already high degree of market integration requires an aggressive "problem solving" methodology. The US and EU regulatory frameworks are non-discriminatory by nature and the free trade agreement could also benefit other trading partners who are not directly involved.

This agreement, when finalized, will have political and economic objectives, but at the same time also social consequences that are difficult to currently gauge.

The main policy objective of the agreement, described by some as "the NATO of trade," is to eliminate

trade barriers in a wide range of economic sectors by harmonizing regulations and procedures in order to meet the rising challenge of the Chinese economy and of the emerging market economies in general. A new huge free trade area that can compete with emerging markets in terms of production costs, but also create a compatible elevated standard so as to prevent "copycat" economies and mass manufacturers, like China, to compete solely in terms of costs but also on the quality of the goods provided (for example, without the use of harmful substances during the production phase).

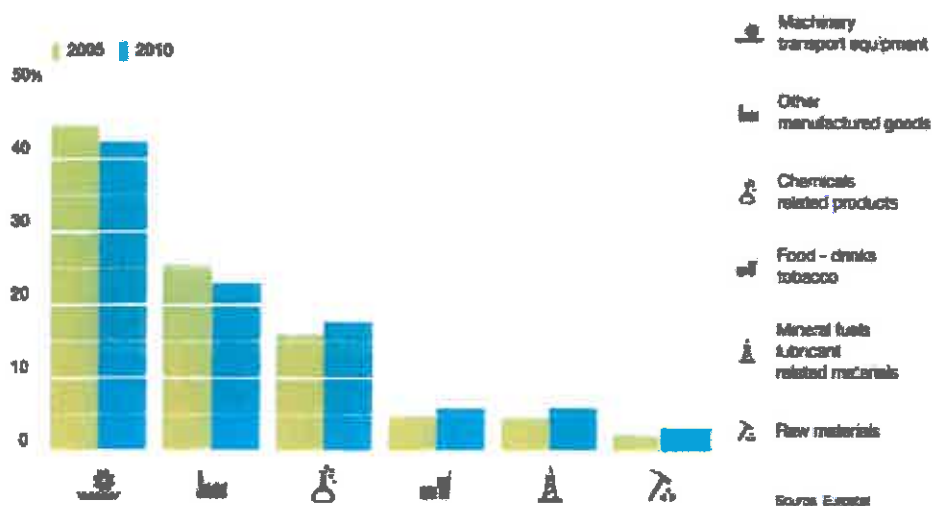
I believe, however, that the objective of the agreement between the EU and the US is to establish reciprocal respect within this huge new free trade area. Within each group or sector, there will be winners and losers.

The EU's main exports are in the Machinery & Transport Equipment and Manufactured Goods sectors. Germany is the EU member with the largest share of these products and hence could benefit most from the signing of the US-EU trade agreement as it is the biggest producer but would also find an easy inroad into the US with the adoption of common standards, the absence of which blocks certain German exports to the US.

The risk is that this free trade agreement weakens even further those fragile eurozone economies that cannot, due to internal rigidities, transform their production systems to withstand the new competition and the consequent fall in prices.

Furthermore, I wonder if the eurozone countries already currently in difficulty on the back of the recession and austerity measures are capable of supporting any new shock due to a change in the industrial system, and to a new wave of financial liberalization which was perhaps the basis of the current crisis. Think of the European manufacturing industry, so vital to the EU economy, increasingly subject to competition from their US counterparts which are continually increasing significant market share year in and year out on the back of a massive use of industrial robotics. As highlighted in the Boston Consulting study of 2011, "Made in America, Again: Why Manufacturing Will Return to the US," while the world was still in shock after the 9/11 terrorist attacks, the WTO launched its development strategy in Doha and China adhered to the Organization, the average salary in the US was approximately 22

MAJOR EXPORTS OF THE 27 COUNTRIES OF THE EU BETWEEN 2005 AND 2010



times that of the Chinese. The productivity ratio between the US and China was one to three back then, and has remained basically unchanged since. But within the space of ten years, there have been dramatic changes, and reliable forecasts currently indicate that by 2015 the difference in the total costs of production for medium labor-intensive and low labor-intensive manufactured goods will decrease by 10%. Hence, the US's "re-manufacturing" process is not too far away in time. In view of the current analysis that we are undertaking, this will be one of the upcoming challenges for the EU which will be made even more difficult by the potential approval of the TTIP.

Attention should be paid to the fact that the US-EU free trade agreement will touch the heart of the core values and basic functioning of EU society and its different components. Just think of the diverse cultural and legal frameworks of the two parties in terms of environmental issues, the use of GMO products, or the protected designation of origin of products, just to name a few; or the consequences on the agricultural industry, starting from the EU common policy.

There may be important consequences to the labor markets, environmental protection, healthcare, education, and many more areas. Only culture and the arts do not seem to be involved (especially due to the insistence of the French) under the tutelage of the proposed agreement. And to date, the majority of the European populace is unaware of the significant consequences that the signing of the agreement could bring.