

Langhammer, Rolf J.

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## Why a market place must not discriminate: The case against a US-EU free trade agreement

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**Why a Marketplace Must Not Discriminate:**



*Kiel*

## **Working Papers**

**Kiel Institute  
for the World Economy**



**Why a Market Place Must Not  
Discriminate: The Case Against a  
US-EU Free Trade Agreement**

**by Rolf J. Langhammer**

**No. 1407 | March, 2008**

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## **Why a Marketplace Must Not Discriminate: The Case against a US-EU Free Trade Agreement**

Rolf J. Langhammer

### **Abstract:**

The paper discusses the pros and cons of a Transatlantic free trade area (TAFTA) against the concept of an informal trade-facilitating marketplace between Europe and the US. It finds considerably more cons especially since TAFTA would be expected to have ever more discriminatory effects to the detriment of dynamic non-member economies mainly in Asia but also in food-exporting regions. Efficiency-enhancing effects are argued to be achievable under a marketplace concept which does not separate insiders from outsiders. It is also shown that in foreign direct investment (FDI) and FDI-related service trade TAFTA seems redundant as in recent years bilateral capital and trade flows have proven to be buoyant without preferential treatment.

Keywords: Regional trading arrangement, multilateral trade policy, free trade area

JEL classification: F13, F15

### **Rolf J. Langhammer**

Kiel Institute for the World Economy  
24100 Kiel, Germany  
Telephone: +49 431 8814 203  
E-mail: rolf.langhammer@ifw-kiel.de

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## **I. Introduction<sup>1</sup>**

Since more than ten years, the so-called New Transatlantic Agenda (NTA) approved at the EU-US summit in 1995 has triggered ideas on deepening economic interactions between the US and the EU. Acronyms like the Transatlantic Economic Partnership TEP created in 1998 or the New Transatlantic Marketplace NTM (proposed in 1998 by Sir Leon Brittan, Mr. Bangemann and Mr. Monti) were expected to materialise in specific projects. Furthermore, these initiatives were intended to contribute to the dismantling of informal and formal trade barriers and to operationalise on the TEP without suggesting an exclusion effect for non-member countries. In fact, the concept of a Transatlantic Free Trade Area (TAFTA) which would have encompassed such an exclusion effect was never strongly articulated nor developed. Few research on TAFTA exists relative to that on other prospective integration schemes (Langhammer et al. 2002, Siebert 2004) and this invites two hypotheses. First, there are already close trade-creating substitutes to TAFTA which deliver similar results without severe conflicts. Then, TAFTA if targeted towards trade creation would be widely redundant. Second, there are no substitutes but the road to TAFTA is a pothole road with easier avenues at hand (such as multilateral negotiations minimising trade-diverting effects).

Until the recent past, such low profile towards TAFTA was maintained but now seems diminishing for two reasons. First, the multilateral Doha Round negotiations under the auspices of the WTO are trapped in a tripartite mercantilist game between the US, the EU and the emerging markets. While the EU and the US seem unprepared to bind the state of agricultural concessions which they already effectively apply, the emerging markets seem unprepared to bind access to their industrial markets again at the level of effectively applied tariffs. Intra-sectoral reciprocity requested by the US in the agricultural sector (mutual concessions are claimed to be exchanged in agriculture one by one) seems unacceptable for emerging markets whose economic dynamics sentence gains from the Doha Round to small numbers in relative terms. The vacuum left by weakened multilateralism could rapidly be filled by bilateralism not only in US-Asia or EU-Asia relationship but also between the US and the EU.

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<sup>1</sup> Paper presented at the 1st Transatlantic Economic Dialogue „A Declining Regime? America and Europe in the Multilateral Trading System“ organized by the BMW Foundation Herbert Quandt, GARNET The European Network of Excellence on “Global Governance, Regionalisation and Regulation: the Role of the EU”, and the Center for Transatlantic Relations The Paul H. Nitze School of Advanced International Studies Johns Hopkins University. The author thanks discussants and participants for helpful comments and suggestions.

Second, and this is the major concern, on both sides of the Atlantic ocean fears about the East Asian suppliers are widely spread. Such fears have found simple eye-catching headlines such as “globalisation has gone too far” and “our wages are made in Beijing”.

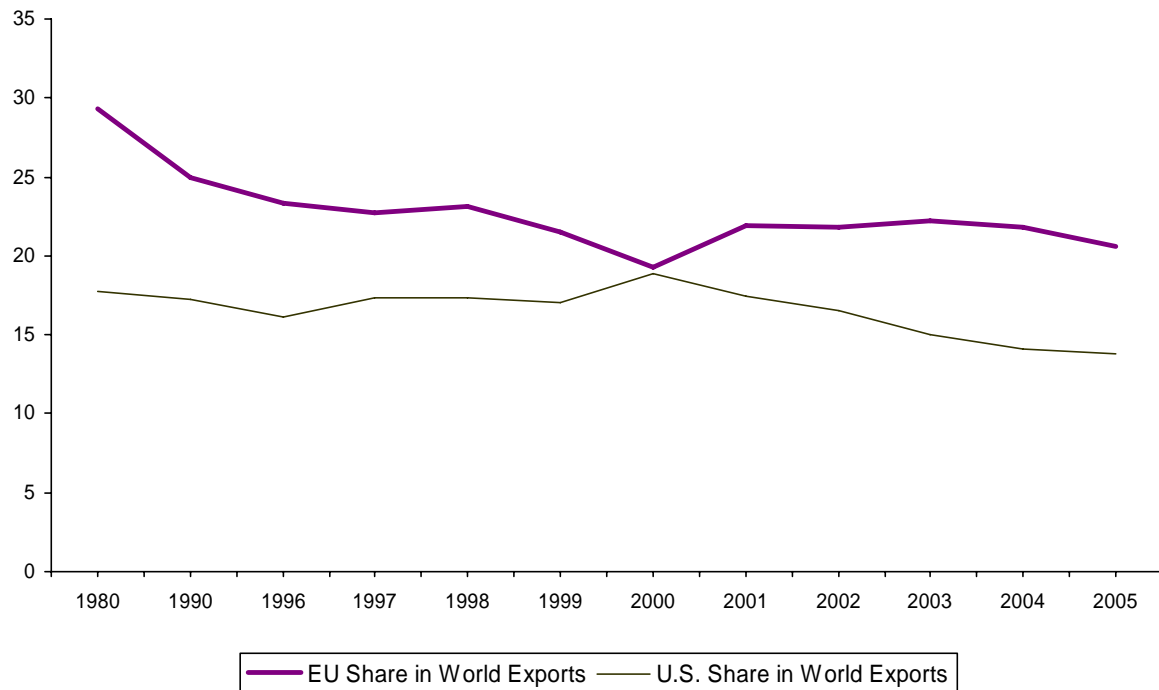
It is against this background where any trade-related agreement between the US and EU has to be scrutinised whether it comprises exclusion effects and discriminates against non-member countries. Such discrimination would not only be to the detriment of these countries but would also impair the interests of many actors in TAFTA being deprived of cheap sourcing or being discriminated as foreign investor outside the TAFTA area.

The paper first provides some stylised facts on the development of both TAFTA area trade relative to the rest of the world and intra-versus extra-TAFTA area foreign direct investment (Section II). Trade will be decomposed into merchandise and service trade in order to account for differences in dynamics and market accessibility between traded goods and services. It will be shown that recent dynamics are rooted in extra-TAFTA area trade and that this has implications for the balance between the competition enhancing effects and the discriminatory effects of a formal agreement. Section III then elaborates on the general pros of a formal TAFTA. In essence, this is the argument that bilaterals between partner countries with low tariffs on goods imported from the rest of the world (other than the signatories) look for “market opening” rather than for “market preferences” (Messerlin, 2007). Section IV gives room to the cons side of a TAFTA which is basically the discussion of how important could be specific adverse effects against non-TAFTA countries. Section V weighs pros and cons and concludes.

## **II. TAFTA Trade in Merchandise Goods and Services and TAFTA FDI in a Global Perspective**

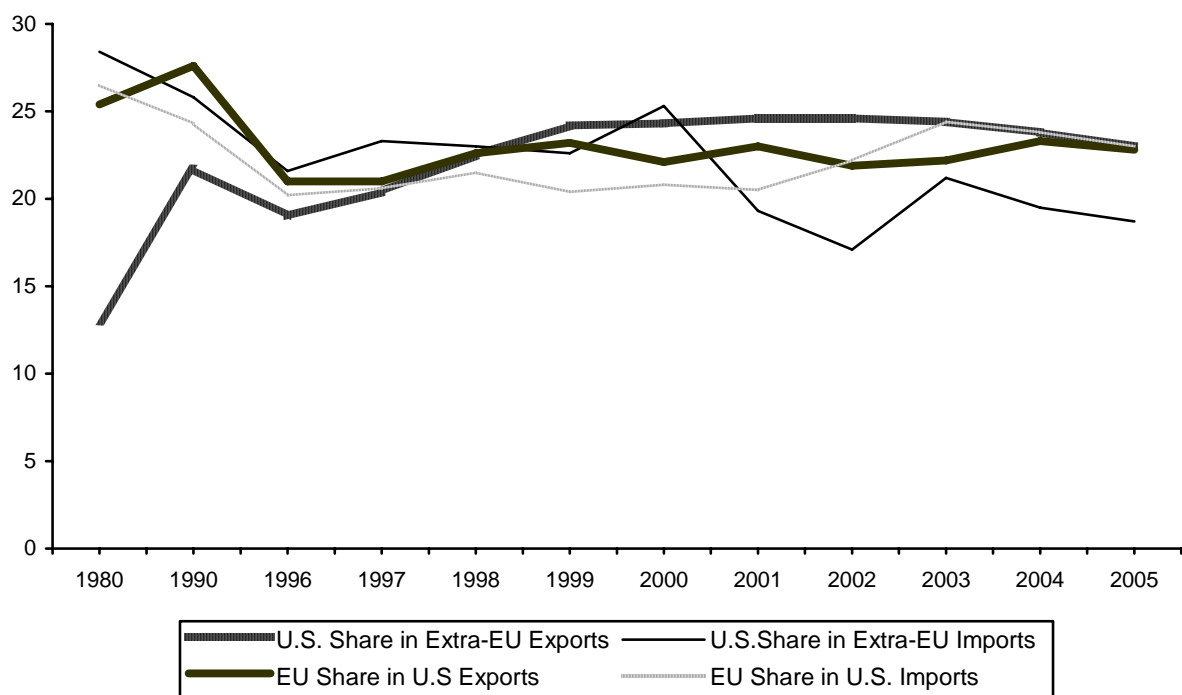
Figure 1 displays an expected development. Since 1980, both the US and the EU command a declining share in world in manufactured exports. The emergence of new suppliers in newly industrialising economies stands behind this development and does not exempt the importance of each trading region in sourcing and sales of the other region. This importance has been declining as well as seen from the ever smaller share of both the US in total extra-EU manufactured exports and imports and the EU in US total manufactured imports and exports (Figure 2). The decline in both shares suggests more potential for trade-diverting effects from preferences at the expense of trade-creating effects today than in the past. In other words, given that the dynamic elements in world trade today are rooted more in extra-TAFTA than in intra-TAFTA trade, the welfare-decreasing effects of extra-area trade

**Figure 1: EU 15 and U.S. Shares in World Exports in Manufactures, 1980-2005 (in per cent)**



Source: UN Monthly Bulletin of Statistics, various issues

**Figure 2: Intra-Tafta Trade Shares in Total U.S. and EU Trade in Manufactures, 1980-2005 (in per cent)**



Source: UN Monthly Bulletin of Statistics, various issues

discrimination due to TAFTA relative to the welfare-increasing effects of intra-area trade enhancement today weigh more than 25 years ago. Declines have been distinct on the EU side where the share of the US in EU manufactured imports slumped by 10 percentage points over that period<sup>2</sup> while the EU losses in both US manufactured imports and exports remained within a slot of 3-4 percentage points. Seen against consistently higher economic growth in the US than in the EU during that period, it seems that the US had to face larger challenges to maintain its position against price-competitive suppliers from emerging markets in a slowly growing market like the EU than the EU had in the more buoyant US market. This could indicate a stronger interest in the USA to preserve a competitive edge over competing non-EU suppliers in the EU through preferential margins than perhaps the EU would address with respect to its interests in enjoying preferential access to the US market against non-US suppliers.

While trade shares in manufacturing are fairly well recorded, relatively little is known with respect to the importance and the development of transatlantic service trade. Yet, it is just this trade which is driven by a number of factors in the same upward way (i.e., mobility of people, improvements in cross-border communication technology, rise in transatlantic foreign direct investment (FDI)) where barriers can be expected to be manifold and disperse since they are much less rooted in border charges and more in “behind the border” barriers. Hence, it is this trade which warrants most attention in discussing the potential effects of TAFTA especially because multilateral trade liberalisation has been far less advanced in services than in merchandise trade.

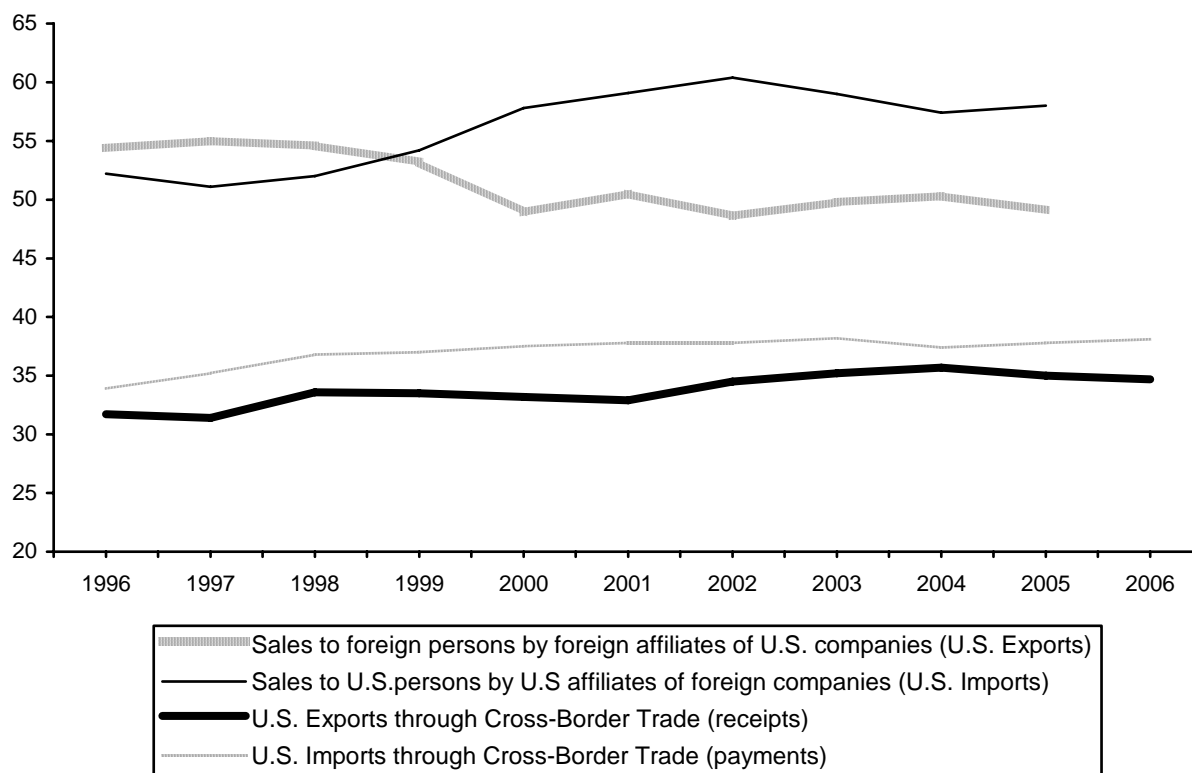
US trade statistics allow for differentiation between so-called mode 1 supply (cross-border trade), through the exchange of services via net and web, and so-called mode-3 supply (commercial presence) through foreign affiliates. It is striking that the importance of the EU as sourcing or selling market for the US differs very much between the two modes. As concerns the importance of the EU in US cross-border trade in services, the EU market accounts for about one third of US sales, far more than in merchandise trade while less than 40 per cent of US cross-border imports of services originate from the EU (Figure 3). Trade shares are rising. This may invite the conclusion that the risk of discriminatory trade diversion within TAFTA seems smaller in trade in services than in merchandise trade due to the fact that the tradability of services, the openness of service markets and thus the supply in competitive services is smaller outside than inside TAFTA. Yet, this conclusion may soon

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<sup>2</sup> By and large, since 1990 the US could defend its share in EU exports with minor declines in the recent past.

become questionable once emerging markets benefits from technological leapfrogs and are prepared to open their part of their service markets unilaterally.

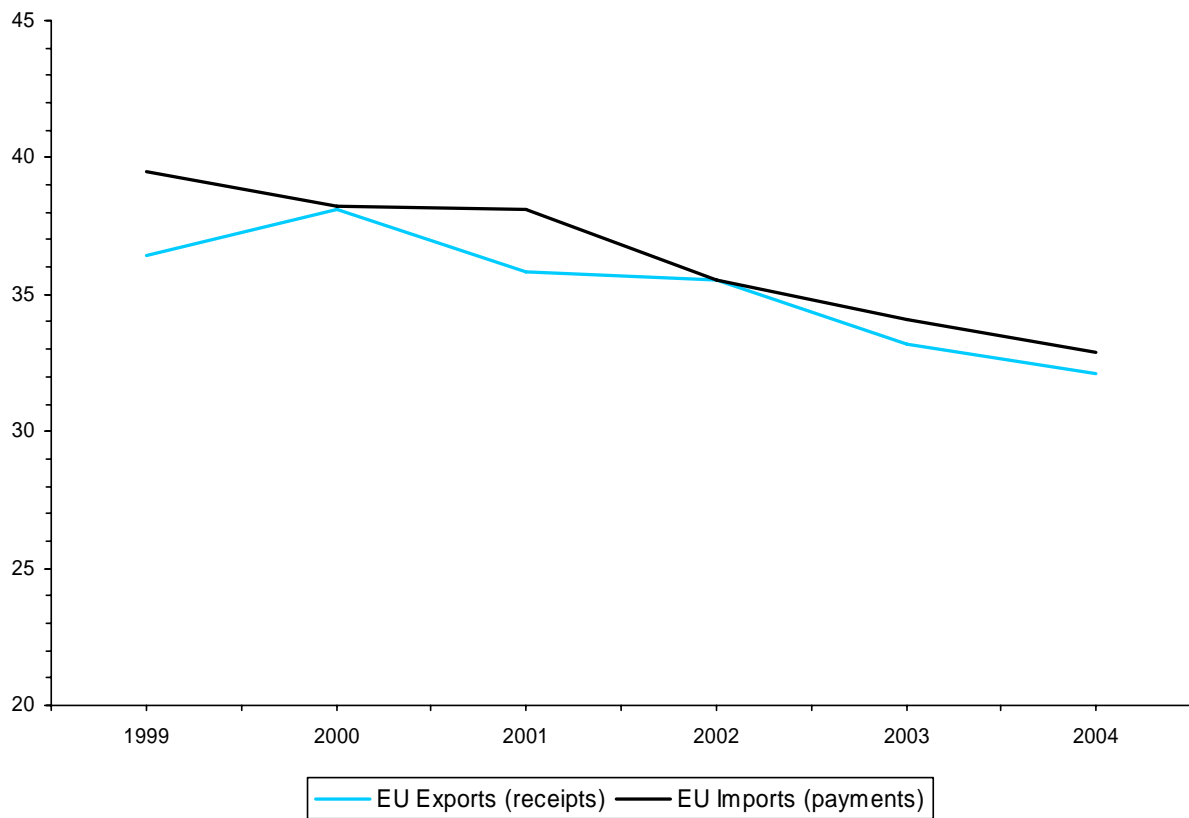
**Figure 3: EU Shares in U.S. Trade in Services through Cross-Border Trade (Mode 1 Supply) and through Foreign Affiliates (Mode 3 Supply), 1996-2006 (in per cent)**



Source: U.S. Department of Commerce, Survey of Current Business, 2007



**Figure 4:** U.S. Share in Extra-EU Cross-Border Trade in Services, EU 15  
1999-2002, EU 25, 2003-04 (in per cent)



*Source:* OECD Statistics on International Trade in Services, Volume 2, 2004-2007

Figure 3 also displays the role of the EU in the mode-3 part of US trade in services, via commercial presence of foreign affiliates in the partner country. Here, the importance of the EU in total US exports (sales of US affiliates operating in the EU and selling services to foreigners) and total imports (sales of EU affiliates operating in the US and selling services to US residents) is the highest. It approaches the 50 per cent level in US exports and almost 60 per cent in US imports. This illustrates the dominance of transatlantic service trade through multinational companies (mode 3) and the importance of bilateral trade relations the dynamics of which today are based more on equity capital flows than on exchange of goods. It also illustrates that the spectacular rise of transatlantic trade in mode-3 services relative to trade of the US and the EU with the rest of world has been achieved without preferential treatment and even occurred over a period during which service trade was liberalised unilaterally rather than on a preferential or multilateral base.

Data on the importance of the US in EU trade in services are only available for cross-border trade (Figure 4). Here the US has proved to be far less attractive both as source and destination for the EU than did the EU for the US. There has been a steady decline in the share of the US in total EU cross-border service exports and imports between 1999 and 2004, albeit within a narrow band of 34-40 per cent.

When looking at the third indicator of transatlantic economic relationship, the importance of each partner in FDI stock of the other partner, the analogy to service trade is large. The EU share in US FDI stock has been rising over time from 38 percent in 1980 to almost 47 per cent in 2006 (Figure 5). This rise reflects the importance of the EU as a host market for US FDI in services. Here the increase over time from 23 to 47 per cent in services has been outstanding while in the manufacturing sector a high level of 45-50 per cent could be maintained. This could support the view that US investment in Europe did not only follow price signals like the US\$/Euro exchange rate changes. It may have also adhered to incentives to locate in Europe due to the implementation of the single market programme which paved the way to internal market completion in services and provided a more uniform regulatory framework than before. Again, foreign investors seemingly were not attracted by preferential relations but by the deepening of the EU internal market from which all EU partners could benefit.

Again, as in cross-border trade, the reverse direction highlighting the importance of the US in extra-EU FDI stock does not mirror the same result. Here, the US market has been generally declining as a host for EU investment since 2000 basically due to the attractiveness of Eastern Europe and emerging markets for EU investors.

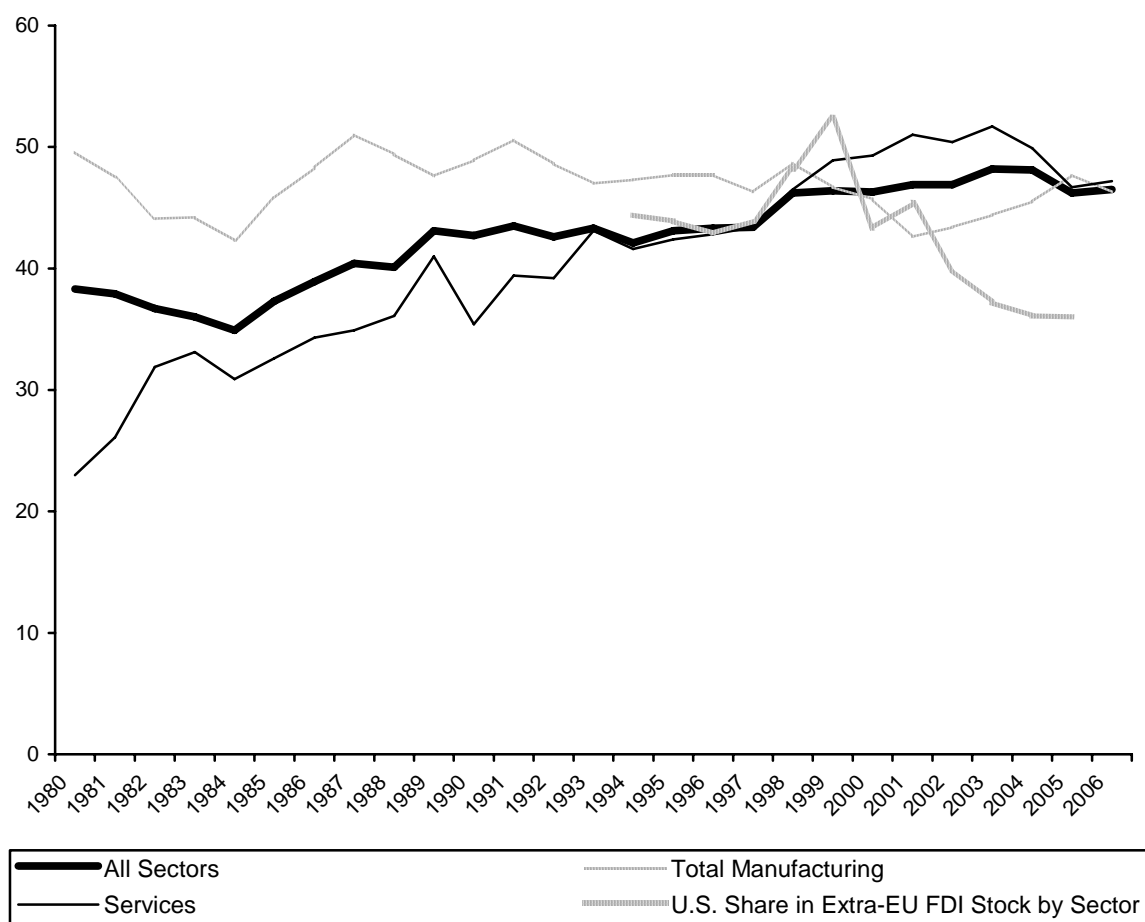
What do these developments in mutual trade and FDI shares suggest for the likely effects of a free trade area?

First, in merchandise trade, an FTA is unlikely to divert the tide of dynamics of extra-transatlantic trade in favour of intra-TAFTA flows, and if so at high efficiency costs only.

Second, the rapid growth of transatlantic trade in mode-3 services has been maintained without preferential treatment and has matched the dynamics of EU investment in US markets without preferences. This is important since making US or EU-based companies eligible for preferential treatment, for instance, in rights of establishment, would be meaningless for companies which act locally or globally but never regionally only. It would be equally meaningless for companies being in a continuous change of their geographic composition of

activities. It is unlikely that there would be a single US or EU-based company which has no commercial ties outside the TAFTA area.

**Figure 5: EU 15 Share in U.S. FDI Stock by Sector, 1980-2006 and U.S. Share in Total Extra-EU FDI Stock, 1994-2005 (in per cent)**



Source: US Department of Commerce, Survey of Current Business, 2007; EU FDI Yearbooks 2000-2007

In brief, while the FTA follows the traditional GDP concept benefitting the TAFTA territory against the rest of the world, the importance of FDI and FDI-related services in both US and EU economic relations supports the GNI concept benefiting income generation of TAFTA residents against non-TAFTA residents throughout the world. The latter concept clearly speaks for the market place idea which is inherently multilateral but not regional.

Third, the data suggest some imbalances in the importance of each partner for one another. While the EU has become increasingly important for US FDI, this has not been matched on the EU side as concerns EU FDI in the US. EU policy-makers could ask whether policy-induced barriers for foreign companies acting in the US are more restrictive than barriers for foreign companies acting in the EU and whether any negotiations on making the

marketplace equally open on both sides of the Atlantic should not primarily concentrate on a level playing field target.

### **III. Could TAFTA Head for Market Opening rather than for Market Preferences?**

It cannot be denied that both the EU and the US are low-tariff partners in *industrial goods*. The EU and the US entered the Doha Round negotiations with an average bound industrial goods tariff of 4.0 per cent and 3.4 per cent, respectively, and with an average applied tariff of 3.9 per cent and 2.6 per cent, respectively. Hence, while there has been some binding overhang in the US tariff, there was almost no water in the EU tariff. These tariffs are imposed on intra-transatlantic trade. Assuming the Doha Round would finally conclude with an ambitious tariff cut by industrial countries (with a Swiss tariff cutting formula coefficient of 10:Swiss10), the resulting average bound tariff would undercut the initial pre-Doha applied tariff in both WTO partners (2.4 per cent for the EU and 1.9 per cent for US) and thus allow for real trade effects (Messerlin 2006). But it would also mean that the additional trade-generating effects resulting from bringing tariffs on intra-TAFTA trade down to zero would be small in terms of import growth. As a back-on-the-envelope calculation, with a price elasticity of import demand of 1.5 and full pass-on of tariff change to a price change, US imports from the EU would grow by 2.7 per cent (once and for all) and EU imports from the US would grow by 3.5 per cent if after concluding the Doha Round both partners would join in TAFTA and apply zero tariffs on bilateral trade. This is an effect which can be easily achieved via normal income growth and is within fractions of a percentage point of GDP.

There is of course the issue of peak tariffs which after a Doha Round with a Swiss10 formula would still amount to 8.5 per cent in the EU and 7.9 per cent in the US. These peak tariffs account for only 7 per cent of all tariff lines in the EU and 8 per cent in the US and are basically relevant for labour-intensive consumer goods imported from the developing countries and emerging countries. So at first glance and under the assumption that there is little substitutability between a TAFTA supply and supply of developing countries, there is little trade diversion to be expected from the maintenance of peak tariffs against non-TAFTA supply and zero tariffs on transatlantic supply after the formation of TAFTA.

Yet, this assumption can be questioned. Non-TAFTA countries could point to the resistance of the two partners in the past to fully dismantle non-tariff barriers in textiles, clothing and footwear imports from Asian suppliers, to the insistence on safeguard clauses against short-term market disruption, and to the many anti-dumping investigations opened against

Asian suppliers in particular against China<sup>3</sup> in labour-intensive manufactures both by the EU and the US. Both EU Mediterranean countries and some US states host suppliers of products which directly compete with the Asian supply (less important: Latin American supply) under perfect competition and thus are very sensitive to price competition. Free trade between the EU and the US would then fuel trade diversion in peak tariff items to the detriment of Asian suppliers and provoke trade policy disputes<sup>4</sup>.

Without doubt, with the exception of the peak tariff items, the pro argument for TAFTA derived from generally low tariffs on industrial goods remains valid. Yet, it also underlines the argument of TAFTA redundancy. If trade diversion is small it can nevertheless be avoided by multilateral trade liberalisation without sacrificing trade-creating effects, that is substituting domestic production for trade (albeit not necessarily with the EU alone but with other partners as well).

Would TAFTA be also a low-tariff partnership in *agricultural goods*? In this context, one has to differentiate between the three elements of intervention into agricultural markets: export subsidies, domestic support and market access.

The issue of tariffs is reflected in the market access element. One key to address this issue is to compare the EU and US proposals for tariff cuts in the Doha Round farm negotiations for tariffs imposed on imports from developed countries. This would cover transatlantic trade in farm products. The structure of proposals may provide hints for the demand for protection revealed by each partner.

First, the proposed US tariff cut is larger than that of the EU (Table 1). This possibly mirrors the lower importance of tariffs in US agricultural protection relative to the EU because it was primarily the EU which in the Uruguay Round converted NTBs into tariffs (“tariffication”) using specific tariffs. Second, though the EU proposal is the highest in the highest tariff range, following this proposal would mean to maintain higher protection in those items which are initially more protected. Furthermore, relatively deep cuts would emerge in those items which show already low tariffs. Knowing that the EU tariff structure in agricultural products has the traditional bias against processed goods (food products) over unprocessed products (farm products) that bias will be maintained and thus will continue to hamper

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<sup>3</sup> Even after its entry into the WTO, China remains the main target of US and EU contingent protection measures.

<sup>4</sup> Peak tariffs are also the reason for bilateral complaints: For instance, the EU criticises US peak tariffs for leather products and shoes (with peak tariffs up to 48 per cent) and the refusal of the US government to let the EU participate in government procurement tenders for shoes in the US military service.

transatlantic trade in food products more than in raw material-based farm products. In brief, effective rates of protection would continue to exceed nominal rates of protection and thus discriminate against more labour-intensive processed food trade.

Dismantling these tariffs in TAFTA would probably give a large impulse to transatlantic trade in food manufacturing but as these are just those products which would continue to be relatively highly protected against developing countries, the trade diversion potential would also be large and provoke disputes with non-TAFTA food exporters such as Australia, New Zealand, Brazil and Argentina. It seems that –only based on hypothetical free TAFTA trade– US food exports would benefit more than EU food exports.

Table 1 EU and US Market Access Proposals in the Doha Round for Agricultural Products originating from Development Countries

EU Proposal		US proposal	
Initial tariff range (%)	Tariff cut (%)	Initial tariff range (%)	Tariff cut (%)
> 90	60	>60	85-90
60-90	50	40-60	75-85
30-60	45	20-40	65-75
0-30	35	0-20	55-65

Source: Messerlin 2006

Finally, would TAFTA be a low tariff partnership in *services*?

This is most difficult to answer since tariffs in service trade are rare exceptions. Barriers to foreign trade in services are mostly regulations which either discriminate against market access of foreign suppliers (border measures) and/or treat foreign suppliers less favourably than domestic suppliers (behind-border measures). Estimates on tariff equivalents for service trade regulations are seriously flawed because of conceptual and empirical weaknesses (Findlay, Warren 2000; National Agency (2005). Various restrictiveness indices have been introduced as proxies and were used as right-hand variables for calculating cost and price effects of barriers. Assume flaws in these proxies are systematic and do not strongly distort comparisons of restrictiveness levels between countries. Then, EU and US levels of trade restrictiveness have been sometimes found to be relatively similar (and low) relative to other countries but sometimes also very disperse. For instance, McGuire and Schuele (2000: 222) estimate a foreign trade restrictiveness index in banking services for the US of 0.06 and for

EU countries of 0.07, against an average of 0.19 for 27 OECD and non-OECD economies. Yet, in maritime services, (McGuire, Schuele, Smith ,2000:194) find restrictiveness indexes for foreign trade of 0.6 for the US against Germany of 0.390, the UK of 0.239, Sweden of 0.415 and Denmark of 0.284.

Warren (2000: 79) reports restrictiveness indexes to trade in telecommunications services based of 1997 data of 3 for the US, zero for the UK, 5 for Germany, 21 for France, 41 for Spain just to name the largest EU member states. The highest restrictions have been found for Turkey (80) with 100 as the maximum score.

It is certainly true that the EU internal market for services has become more integrated over the last decade not only due to a number of services directives launched by the Commission but also because of technological innovations and rising intra-EU FDI flows in service industries. Likewise it is true that barriers to service trade have become de facto smaller again because of technological innovations (shifts from less to more technology-intensive modes of supply). But it cannot be doubted that the level of market integration of services in Europe still lags behind that of market integration in goods and that the EU is neither yet a full free trade area in services nor a customs union (Langhammer 2005).

What do these three examples say for a US-EU FTA in services on the one hand and for third countries on the other hand? First, the service sector is most heterogeneous, in the EU, the US and elsewhere. This is reflected in the differences between US or EU levels of restrictiveness and the rest of the world, and in the differences between EU member states. Second, an across-the board TAFTA in services is not on the short-run agenda, simply because the EU cannot negotiate with the US at level playing field. EU member states insist on special derogations for special services and for special modes of supply. The largest differences between EU member states' policies exist for mode-4 supply, temporary movement of persons. That would require service sector-specific agreements such as in air transport but not for all-embracing horizontal commitments for all services. Third, given that the combined EU member states share (including intra-EU trade) and US share in world service exports amounted to 60 per cent in 2006 and that the share of intra-transatlantic trade in total service trade of the two partners including foreign affiliates trade has been rising (see section II), risks of trade diversion seem to be manageable. Yet, the dynamics in service trade match the dynamics of economic growth in emerging markets. With reference to the most disperse sector among the three examples in terms of restrictiveness, the maritime services, third country suppliers could become seriously discriminated against if the US would treat

domestic suppliers and EU suppliers of maritime services alike while maintaining restrictions against third countries. Thus, it is probably still misleading to belittle risks of trade diversion and third country discrimination in US-EU trade in services if specific service sectors would come to an agreement on transatlantic free trade while others would not.

In total, the pro arguments which are based on high trade-creating effects and low trade-diverting effects due to a TAFTA are relevant if compared to South-South trade agreements or bilaterals of the EU and the US with developing countries. Yet, they cannot be taken for granted if the future potential of emerging markets in their export supply is taken into account. This holds for all three sub-sectors.

#### **IV. The cons against TAFTA**

##### **1. Much input, little output**

TAFTA effects in terms of GDP changes based on computable general equilibrium models have been assessed by Baldwin and Francois (1997). Offering various alternatives which range from limited preferential agreements to a Transatlantic Economic Space with standards harmonisation and deepening of the procurement agreement the studies strongly underline the superiority of multilateral approaches both for TAFTA partners (by factor 10) and for the rest of the world. Negative effects for third countries have been identified but they are small. It is important to note that transatlantic liberalisation does not include the EU and the US but also corresponding steps by the two other NAFTA members Mexico and Canada. Even including the NAFTA partners income effects remained at the level of 0.3 per cent of GDP. It is unlikely that more recent data would come to different results just for the two main reasons discussed above: first, barriers in trade between the EU and the US have been lowered further, either unilaterally, bilaterally or multilaterally. Second, world economic dynamism has ever more shifted to non-TAFTA countries in Asia aggravating the risk that TAFTA would be more trade-diverting than ever.

##### **2. Misleading signals for solving the global imbalance problem**

In recent years, China has accumulated large amounts of dollar-denominated assets (in particular US Treasuries) for various reasons. Among them, there is the still relatively rudimentary state of the domestic financial system which may not yet be a good intermediary for allocating foreign funds into best domestic use, the motive to self-insure against a new Asian crisis, and the interest of China to offer a collateral and an insurance for foreign in-



vestment in its economy. There are good reasons to argue that such strong prudential behaviour should be temporary and that it is costly should the Dollar depreciate. More and better use of savings at home rather than abroad and more domestic demand should be the medium-term target of Chinese economic policies, and such policies would help to reduce global imbalances.

The formation of TAFTA would fly into the face of such efforts. First, it would very likely be interpreted by China and other Asian countries as a defensive measure and perhaps be reciprocated by own restrictive measures against TAFTA suppliers or by further second-best regionalism in Asia. Second, it would raise incentives to hedge against anticipated trade-diverting measures of TAFTA, for instance, by further accumulating foreign assets in terms of reserves and FDI outflows to TAFTA (tariff-jumping) the latter being unnecessary under MFN treatment. Third, it would send a signal against export-oriented FDI from the EU and US in China and other Asian emerging markets as investors would fear to become victims of a concerted TAFTA strategy against alleged dumping from Asia. Investors could thus reduce their extra-TAFTA investment below a desirable level. Fourth, it would enhance a restrictive use of rules of origin in order to discourage so-called trade deflection, using the low-tariff area within TAFTA as a springboard for entering the high-tariff area within TAFTA. Unless TAFTA changes into TACU (a transatlantic customs union), such tariff differences between the EU and the US against third countries will continue to exist in certain sectors, in particular in peak tariff items.

### 3. High complexity because of EU and US third country relations

Traditionally, the EU but in recent years also the US already operate or just negotiate hub-and-spoke systems of free trade agreements on a bilateral (country-to-country) or regional basis (EU-Mercosur agreement). These agreements are overlapping with TAFTA and require complex procedures in order not to violate WTO non-discrimination rules.

Schott and Oegg (2001) raise this issue under the “TAFTA-South” label for EU preferential trade relations with Latin America, in particular with respect to the still spending EU-Mercosur agreement, but also to the EU-Mexico FTA. While they acknowledge some trade diversion concerns in the US to be relevant because EU producers in the US would prefer sourcing from Mexico rather than from the US, their general assessment is positive. EU–Latin America agreements would push both growth and political stability in Latin America and also put pressure on the US to more forcefully pursue their FTA plans in Latin America, in particular the hemispheric FTTA initiative.

However, their assessment is based on the assumption that TAFTA-South is more a substitute rather than a complement to the genuine TAFTA. If we see TAFTA and TAFTA-South as a “joint product” (with TAFTA the TAFTA-South issue must be solved) and if we widen TAFTA-South beyond Latin America to Africa and Asia, the assessment gets more cloudy, especially for third countries. First, FTAs with third countries loose in attractiveness for the partner countries because TAFTA denies them privileged access to the US and EU markets vis-à-vis one of the TAFTA partners. For instance, after TAFTA, Turkey which has an FTA (even a customs union) with the EU but not with the US will face less favourable treatment on the US market against EU suppliers. Similarly, after TAFTA, so-called ACP countries being members of the Cotonou agreement (post-Lomé agreement) of the EU with African, Caribbean and Pacific former colonies but without privileged access to the US market (except for the poorest countries), will face less favourable treatment on the US market against EU suppliers. Vice versa, suppliers from Singapore, Australia, Bahrain, and the Central American countries which all have concluded FTAs with the US but not with the EU, will face less favourable treatment on the EU market against US suppliers. In short, TAFTA depreciates the value of bilateral FTAs for those spokes which are tied to one hub within TAFTA but not to the other: “TAFTA swallows bilaterals”.

Moreover, fundamental differences in reconciling trade, health standards and consumer protection between the US and EU will impact upon third countries. Within TAFTA, the US and the EU should compromise on standards for intra-TAFTA trade with GMO products, for instance. This would have an effect on third countries which, as shown in the Zambian case of EU threats to ban maize imports from Zambia grown from US-originating GMO seeds, suffer from such controversies.

Latin American and African countries are potentially important trading partners especially for commodities but they are less important than Asian countries. TAFTA would certainly influence a “race” between the EU and the US to bilaterals with Asian countries. In this race, the US are still ahead (see the agreement with Singapore) while the EU has waited for the Doha Round to be concluded. It is not unlikely that TAFTA contributes to intensify this race since US companies may exert pressure on their government for preferential access to Asian markets relative to EU companies after having lost these preferences in the free trade agreement. The same strategy could be pursued by European companies. The multilateral trading system would receive a further shock from such a race.

#### 4. Agriculture: the old stumbling block

In all FTAs concluded by the EU and the US, agriculture is "special". To be special usually means to be exempted from free trade arrangements and to violate the "virtually all trade" criterion in Art. XXIV GATT. Yet, it is known that the lack of WTO discipline is the largest in the FTA issue and that except for one integration scheme (the Czech-Slovak customs union) no integration scheme ever received an official "GATT-consistent" certificate. Given the enormous importance of an EU-USA FTA for world trade, it is foreseeable that many WTO member states would claim their benefits arising from the membership as being impaired or nullified should the entire issue of trade-related price and income support measures be exempted from the rule of equal treatment of US and EU farmers. As the level of subsidisation is higher in the EU than in the US, third countries would urge to lower the EU level to the US level and to set this common level as the departure point for further multilaterally negotiated reductions<sup>5</sup>. It is conceivable that any analogy of farm goods trade to industrial goods trade within TAFTA would face unsurmountable political resistance in US and EU political circles.

#### 5. Further issues of conflicts: some basic controversies

Beyond agriculture, one issue of conflicts has already been introduced: health standards and consumer protection. But there are many others. They range from the "grandfather" Boeing-Airbus controversy on open or hidden subsidies via different paradigms in competition policies, security issues and sovereignty issues to government procurement. To the extent that they have straightforward implications for intra-TAFTA trade or - due to TAFTA regulations – change the balance of competition between EU and US suppliers, they will provoke controversies in bilateral negotiations and perhaps be exempted from free trade arrangements.

In the service sector, for instance, one hint to identifying stumbling blocs is to screen the areas of protective measures which both partners have signaled to maintain in the Doha Round<sup>6</sup>. It can be expected that these areas would be "sensitive" within TAFTA too. The EU still restricts access to professional services (accountants, lawyers), personal medical services and education (the latter being defined in many EU member states as a public service open to nationals only) and public utilities like health, environment, and infrastructure. "Needs tests" would probably become a subject in TAFTA negotiations especially if US suppliers seem to

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<sup>5</sup> This is similar to the early EEC period of 1958-68 when the individual member states had different initial tariffs against third countries. They harmonised tariffs and then subjected the common level to tariff reductions under the Dillon and Kennedy Rounds.

<sup>6</sup> Both the EU and the US have tabled their initial offers as well as their conditional revised offers between 2003 and 2007 in the Doha Round. The WTO website publishes those offers which were not classified in the ongoing negotiations.

be competitive. The US apply horizontal restrictions (comprising all services) against the permanent stay of non-US natural persons, against professional services suppliers, such as in legal services, patents, insurances, reinsurances and in the transport sector. Regulations on citizenship of management personnel are widely spread in the banking sector.

It is very likely that trade in services especially under modes 3 and 4 would be subject to many exemptions in a TAFTA agreement.

## **V. Good bye TAFTA, hello TALI**

Transatlantic leadership in global trade policies is badly needed but the way via TAFTA – regardless of whether or not it is a dead horse - is an impasse. This paper has argued that transatlantic leadership in the self-interest of both US/EU consumers and US/EU companies which buy, source, and sell globally requires a governance response to a private sector-driven marketplace project. This response could be labeled transatlantic liberalisation initiative (TALI) intended to facilitate global trade by multilateralising rules for transaction procedures concluded between the EU and the US and extended to third parties (Langhammer et al., 2002)<sup>7</sup>. Such rules comprise customs declaration procedures, preinspection standards, mutual test recognition, transshipment rules etcetera. They would contribute to reduce trade costs. Ideally and more demanding would be TALI if it would release the multilateral trade negotiations under Doha from the mercantilist quagmire for which the EU and the US have been responsible too. This could be achieved by a joint generous kick-off concession in agriculture, NAMA and services. If not, TALI would preferably rely on trade cost-cutting suggestions coming from US/EU consumer associations and company representatives. Third parties would be invited to participate at level playing field. The open marketplace concept would not be responsible for inducing capital to flow upstream, from the poorer to the richer countries, in order to jump over tariff hurdles while TAFTA would at least be susceptible to induce such reaction. By refraining from any trade policy discrimination, the US and the EU would provide a valuable service to developing countries being short of private risk capital.

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<sup>7</sup> TALI is strictly multilateral and should not be equated with a „WTO plus“ policy of adding regionalism to multilateralism rightly criticised by Bhagwati (Bhagwati and Krueger, 1995:7).

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