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The Challenges of Negotiating a Transatlantic Trade and Investment Partnership

by Simon Lester

In his State of the Union speech, President Obama announced that the United States will launch talks on a comprehensive Transatlantic Trade and Investment Partnership with the European Union. This initiative is big news, and potentially a game-changer for trade liberalization. For years now, trade talks at the World Trade Organization (WTO) and other fora have been stalled or grinding along slowly. By limiting the transatlantic talks to two economies that are relatively supportive of free trade, and are at the same development level, perhaps trade negotiators will at last have some success. A completed agreement here could generate momentum for broader trade liberalization around the world. More immediately, the economic benefits of this trade deal would be great, as the United States and the European Union are the two largest economies in the world, and their trade flows with the world account for almost one third of global trade.

However, there may be some stumbling blocks along the way. If the United States and the European Union take on an agenda that is too broad, it may turn out that these trade talks fare no better than other current trade talks. In order to succeed, it is important that the negotiations have realistic goals and a clear path to completion.

The precise scope of the talks remains somewhat vague at this point, but a framework is set out in the Final Report of the U.S.–EU High-Level Working Group on Jobs and Growth.¹ The report indicates that various forms of protectionism will be addressed, and also suggests that the talks will delve further into domestic regulatory issues than most current trade agreements do. While such an expansion of international trade rules does hold the poten-

tial for significant economic benefits, it also tests the limits of how far trade agreements can go in terms of global trade governance. Including issues that the trading system cannot handle may doom the talks from the start, and negotiators should be careful about how they approach this.

The High-Level Working Group Report

In setting out a framework for the talks, the report blurs together some very different issues, and in doing so makes the scope and coverage of the negotiations a bit unclear. The report describes three categories of issues the negotiators will address:

- *Market Access*: The report groups traditional forms of protectionism, such as tariffs, barriers to services trade, and discriminatory government procurement, together with the protection of foreign investments;
- *Regulatory Issues and Non-Tariff Barriers*: The report covers issues of regulatory trade barriers (which may or may not be protectionist), regulatory divergence across countries, and also harmonization of the domestic regulatory process;
- *Rules Addressing Shared Global Trade Challenges and Opportunities*: The report includes a hodge-podge of issues, such as intellectual property, labor, environment, and “localization” issues, among others.

Making sense of the content of the proposed talks is difficult based on this framework. There are examples of protectionism in all three categories, and the groupings obscure important distinctions between the different policies pursued (e.g., intellectual property and discrimination through “localization” measures fall in the same category). To better understand the issues that will be subject to nego-

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tiations, this paper separates out protectionism from less traditional trade issues, and discusses some of the implications of going beyond protectionism in particular areas.

Protectionism

The report addresses issues of protectionism in four main ways. First, with regard to tariffs on trade in goods, the report recommends that

the goal of the agreement should be to eliminate all duties on bilateral trade, with a substantial elimination of tariffs upon entry into force, and a phasing out of all but the most sensitive tariffs in a short time frame.

Eliminating tariffs, even if it may go slowly for some products, is a core goal of trade liberalization and a clear benefit for consumers and the global economy. While tariffs between the United States and the European Union are relatively low, the amount of trade at stake suggests that the economic benefits of tariff elimination would be large.

As to trade in services, liberalization is more complicated, as most of the protectionism comes through domestic regulation. Here, the report recommends that

the goal should be to bind the highest level of liberalization that each side has achieved in trade agreements to date, while seeking to achieve new market access by addressing remaining long-standing market access barriers, recognizing the sensitive nature of certain sectors.

There are some sensitive issues that arise from how international trade rules on services might interfere with domestic policy autonomy. Nonetheless, as with goods, removing protectionist barriers to trade in services for trade between the United States and the European Union would be a very welcome development.

The report also addresses protectionism in the area of government procurement. It recommends that

the goal of negotiations should be to enhance business opportunities through substantially improved access to government procurement opportunities at all levels of government on the basis of national treatment.

In essence, this means that, in their procurement practices, governments should not discriminate against foreign firms (think of Buy America provisions).

Finally, the report mentions the problem of “localization barriers to trade,” which it describes as

measures designed to protect, favor, or stimulate domestic industries, services providers, or intellectual property at the expense of imported goods, services, or foreign-owned or foreign-developed intellectual property.

This language seems to reflect the general principle of non-discrimination, but it may be an attempt to expand some of

the more specific nondiscrimination rules that already exist in trade agreements.

While these efforts at promoting free trade are good, there are, unfortunately, also some gaps in the effort to take on protectionism. First, with regard to tariffs, there is no mention at all of the so-called trade remedies (antidumping, countervailing duties, and safeguards). And second, there is no discussion of the problem of subsidies, which has been a particular irritant in U.S.–EU trade relations. The United States and the European Union have been battling for years at the WTO over subsidies to their respective aircraft industries. And both have been criticized heavily for their massive subsidies to domestic agricultural producers. These issues seem to be off the table.

Foreign Investment

Over the last several decades, governments have signed on to a variety of international agreements related to foreign investment. Originally, these agreements took the form of bilateral investment treaties. In recent years, though, obligations in this area have been included as separate chapters in trade agreements. These rules have proved controversial, both for their substantive obligations, and also because they allow foreign investors to sue governments in an international tribunal.

On the issue of foreign investment, the report recommends that a U.S.–EU trade agreement

should include investment liberalization and protection provisions based on the highest levels of liberalization and highest standards of protection that both sides have negotiated to date.

This language indicates that the existing international investment rules in current U.S. and EU trade and investment agreements will be duplicated in any U.S.–EU agreement.

It is important to note a distinction between two types of investment policies. First, there are policies related to investment *liberalization*. At its core, liberalization of foreign investment suggests that countries will not discriminate against foreign investors as compared to domestic investors. That means any barriers to an initial foreign investment would be limited to legitimate concerns such as national security; and it means that once a foreign investment has been made, governments will treat domestic and foreign companies the same.

By contrast, investment *protection* is a broader concept. Protection of domestic companies who invest abroad can go beyond simple nondiscrimination. For example, typical international investment rules set out a “minimum standard of treatment,” under which foreign investors are entitled to a certain level of good treatment, and can sue even where the host government’s actions are nondiscriminatory. When combined with the ability of foreign investors to sue governments directly (referred to as investor–state arbitration), these rules have been controversial.

Cross-border flows of investment between the United States and the European Union are quite large. As the report

notes, “the United States and the European Union have directly invested more than \$3.7 trillion/€ 2.8 trillion on both sides of the Atlantic.” All of this investment is beneficial in economic terms. However, it also provides numerous opportunities for investor–state litigation, which may cause concern among groups who worry that these rules interfere with domestic policy autonomy. Under the similar provisions of the North American Free Trade Agreement (NAFTA), Canadian companies have brought 15 cases against the United States in the almost 20 years since the NAFTA was signed.² With EU investment in the United States over seven times the amount of Canadian investment,³ there is the potential for a large number of complaints.

Regulatory Issues

One of the most difficult issues in these negotiations is how to address various concerns about domestic regulation. There are a number of issues within this general category: *Regulation as a trade barrier, international regulatory cooperation, and regulatory practices.*

At the outset, it is worth noting that issues of regulatory *protectionism* are already dealt with under the rules of the WTO. There is a long history of WTO cases—and prior to the WTO, at the General Agreement on Tariffs and Trade (GATT)—dealing with protectionism applied through regulatory measures. Although the report is not completely clear on this point, presumably the United States and the European Union will continue to rely on the WTO to deal with such issues and are not seeking to rewrite the WTO’s jurisprudence.

However, regulations can act as trade barriers even if they are not protectionist. The WTO’s rules deal with this issue as well, but it appears that the United States and the European Union are seeking to push the rules further. In this regard, two of the specific proposals are

- An ambitious “SPS-plus” chapter, including establishing an ongoing mechanism for improved dialogue and cooperation on addressing bilateral sanitary and phytosanitary (SPS) issues. The chapter will seek to build upon the key principles of the World Trade Organization (WTO) SPS Agreement, including the requirements that each side’s SPS measures be based on science and on international standards or scientific risk assessments, applied only to the extent necessary to protect human, animal, or plant life or health, and developed in a transparent manner, without undue delay.
- An ambitious “TBT-plus” chapter, building on horizontal disciplines in the WTO Agreement on Technical Barriers to Trade (TBT), including establishing an ongoing mechanism for improved dialogue and cooperation for addressing bilateral TBT issues. The objectives of the chapter would be to yield greater openness, transparency, and convergence in regulatory approaches and requirements and related standards-development processes, as well as, inter alia, to reduce redundant and burdensome testing and certification requirements, promote confidence

in our respective conformity assessment bodies, and enhance cooperation on conformity assessment and standardization issues globally.

In seeking to expand on both the SPS and TBT agreements, the United States and the European Union seem to be suggesting that the existing rules are inadequate. It is not clear why they think so. There have been a number of WTO disputes under these agreements already. These cases have delved into some very sensitive domestic regulatory issues, and have done so in a way that tries to balance trade issues and domestic policy concerns. WTO disputes between the United States and the European Union have addressed issues such as EU measures related to hormone treated beef and genetically modified organisms. But these disputes have shown how difficult these issues are to resolve. While the United States succeeded on its legal claims, domestic political constraints have prevented the European Union from complying. Perhaps there is room for improvement in the rules here, but without further details, it is difficult to say whether this particular proposal is a sensible one and what its impact might be.

With regard to *regulatory cooperation*, the report refers to “more compatible regulations for goods and services,” and further talks about

Provisions or annexes containing additional commitments or steps aimed at promoting regulatory compatibility in specific, mutually agreed goods and services sectors, with the objective of reducing costs stemming from regulatory differences in specific sectors, including consideration of approaches relating to regulatory harmonization, equivalence, or mutual recognition, where appropriate.

If the goal here is to reduce the costs of arbitrary divergences in regulation across countries, such an effort has the potential to be of great benefit. At the same time, including such rules in trade agreements has not been done before, and carries the risk of taking on new issues that trade agreements cannot handle.

Currently, issues related to incompatible regulations are being pursued in a number of different fora. Outside of trade agreements, the United States and Canada are pursuing these issues through a regulatory cooperation council. And in the trade arena, there are broader talks about regulatory coherence in the Trans Pacific Partnership (TPP). It is not yet clear which forum is the most effective place to address these issues.

Finally, the U.S.–EU trade and investment talks will take on issues of *regulatory practices*, which the TPP is dealing with as well. The report says that the parties should seek to negotiate

Cross-cutting disciplines on regulatory coherence and transparency for the development and implementation of efficient, cost-effective, and more compatible regulations for goods and services, including early consultations on significant regulations, use of impact assessments, periodic review

of existing regulatory measures, and application of good regulatory practices.

Internationalizing the rules of domestic regulation by including general obligations of this type in trade agreements is a significant expansion in the scope of these agreements. Whether such rules can be an effective part of the trade and investment landscape remains to be seen. The issue may prove controversial, as it will lead to a good deal of intrusion into domestic policymaking.

Other Social and Economic Policies

The report is fairly brief in its references to other policies. But there are a few items worth noting.

On intellectual property protection, both the European Union and the United States are committed to a high level of intellectual property protection. However, there are some differences between them, such as the way the European Union protects geographical indications. It is not clear that a U.S.–EU agreement will take on these issues to any great extent. The report states:

The two sides will sustain and enhance their work on IPR [intellectual property rights] issues. The HLWG [High Level Working Group] recommends that both sides explore opportunities to address a limited number of significant IPR issues of interest to either side, without prejudice to the outcome.

Similarly, with regard to the environment, labor, and sustainable development, the United States and the European Union have both pushed these issues in their other trade agreements. The report simply recommends

that the two sides explore opportunities to address these important issues, taking into account work done in the Sustainable Development Chapter of European Union trade agreements and the Environment and Labor Chapters of U.S. trade agreements.

To the extent that the particular obligations pursued by the United States and the European Union in past agreements differ, some controversy may arise for each if these obligations are all incorporated into a U.S.–EU agreement (i.e., the United States incorporates EU provisions on sustainable development, and the European Union incorporates U.S. provisions on labor and the environment). Domestic constituencies may worry about an expansion beyond the existing template.

Other issues that fall under this category include competition policy, state-owned enterprises, and export restrictions on raw materials.

Beyond specific substantive rules, the report's statement that it will "contribute to the development of global rules" is noteworthy. This statement can be interpreted in different ways, but it might suggest that the United States and the European Union would like to use these talks to promote their vision of how trade agreements should play a role in "global trade governance."

Conclusion

In terms of the core obligations related to protectionism, there is much to be happy with in the proposed U.S.–EU trade and investment negotiations from a trade liberalization perspective. It is disappointing that agriculture subsidies and other issues will not be covered, but some long-standing protectionism may be eliminated. Removing protectionist tariffs, services barriers, discriminatory procurement practices, and "localization" requirements is all to the good.

At the same time, like many recent trade agreements, the proposed U.S.–EU talks will push the boundaries of the scope of international economic rules. The investment rules will mirror those included in various other agreements, and will include substantive obligations that go well beyond nondiscrimination, and investor-state provisions to enforce them. And the talks will go further into some areas that are not yet covered, such as harmonizing regulatory procedures. This expansion has potential for promoting greater economic benefits. However, it also carries the risk of pushing further than trade agreements can realistically go and still maintain political support.

The chance of success for these negotiations is difficult to assess. If all goes well, the completion of an agreement between the United States and the European Union could provide a boost to economic growth as well as an impetus for new free trade initiatives worldwide. But if these negotiations get bogged down like so many others have, it may lead to a rethinking of the approach that the United States and others are taking on issues of trade negotiations and free trade.

Notes

1. "Final Report, High Level Working Group on Jobs and Growth," February 11, 2013, <http://www.ustr.gov/about-us/press-office/reports-and-publications/2013/final-report-us-eu-hlwg>.
2. U.S. Department of State, "Cases Filed Against the United States of America," <http://www.state.gov/s/l/c3741.htm>.
3. Census Bureau, "Foreign Direct Investment Position in the United States on a Historical-Cost Basis by Selected Country, 2000 to 2010, and by Industry, 2010" <http://www.census.gov/compendia/statab/2012/tables/12s1291.pdf>.