Transatlantic Free-Trade Agreement: More than just corn and foie gras?

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In summary

- The primary objective of the Transatlantic Free-Trade Agreement is to reinvigorate bilateral trade between the United States and the European Union (USD 600 billion in trade flows and more than USD 1,000 billion in FDI in 2012).
- The potential for cuts in tariffs, which are already reduced between the United States (3.5% on average) and the EU (5.2%) is confined to a few protected sectors. Competitiveness shocks (such as the very low cost of energy in the United States) will be much more decisive in determining the direction of these flows.
- Reductions in non-tariff barriers (NTBs) offer much more potential, in particular through the harmonization of technical and environmental regulations and standards.
- Some sectors where negotiations look set to be delicate (agribusiness/GMOs, financial services, transport and public procurement) could remain outside the scope of the agreement, in addition to sectors already excluded from the negotiating table (audiovisual industry and defense).

The Transatlantic Trade and Investment Partnership would create the largest free-trade area in the world, comprising two powers that together account for 40% of global trade and GDP

Transatlantic trade and investment flows are already very substantial, with goods trade between the two continents of USD 600 billion and cross-investment of more than USD 1,000 billion. Importing 17% of European exports (or USD 634 billion), the United States is the EU's largest foreign market ahead of China, and, providing 11% of total EU imports, its third-biggest source of imports behind China and Russia. Conversely, the EU is the United States' second-largest export market after Canada, consuming 18% of US exports (or USD 231 billion), and its second-biggest source of imports after China, with 17% of US imports. All in all, the trade balance is clearly tilted in favor of the EU, with a surplus resulting in particular from two product categories: machines and motors on the one hand and, on the other, transport equipment including road vehicles (***chart 1***).

Chart 1 : Bilateral exchanges Europe/United States by type of products in 2012 (billion dollars)

	EU to US (a)	US to EU (b)	balance (a)-(b)
Food	8,5	9,0	- 0,5
Beverage and tobacco	10,3	1,7	8,6
Mining of coal and lignite	0,1	6,3	- 6,3
Petroleum and derivative	25,7	18,5	7,2
Pharmaceutical products	39,2	23,9	15,3
Chemicals	44,0	30,9	13,1
Machines and motors	95,1	53,1	42,0
Transportation (auto…)	56,4	15,7	40,7
Measuring instruments	15,3	16,1	- 0,9
Manufacturing products	65,7	38,5	27,2
Others	3,6	17,0	- 13,4
Total	363,9	230,8	133,1

Source : UNCTAD

The momentum in this bilateral trade has nevertheless slowed noticeably due to the economic environment since 2008-2009 and, moreover, for a structural reason: the growing importance of emerging countries and the shift of the world's center of gravity to Asia. By encompassing 40% of global trade and GDP, the free-trade agreement is also a chance to make up for the loss of leadership of the old industrialized countries in the face of growing emerging economies.

Import tariffs are not the main issue, given the reduced customs duties on either side of the Atlantic with the exception of a few protected sectors (agribusiness, clothing-textiles)

Customs duties (***chart 2***) are already quite low on average both in the United States for products imported from the EU (3.5%) and in the EU for products imported from the United States (5.2%). These tariffs have been quite stable during the past five years. A further reduction in tariffs would only have a real impact on trade if it applied to sectors where tariff peaks subsist.

For instance, the most protected products are found in agribusiness and clothing and textiles. Tariffs of up to 57.6% are applied to dairy products entering the EU from the United States (compared with 19.2% in the opposite direction), and 11.5% for clothing (more or less in either direction). Bilateral trade flows in these two sectors remain limited for the time being: USD 26.4 billion for the entire agribusiness sector and USD 2.4 billion for the clothing industry.

For the agreement to be effective, non-tariff barriers (NTBs) above all need to be lowered, in particular in industry, as it is already being planned in the automotive sector

There are many other obstacles to trade in addition to customs duties, such as import quotas, public procurement rules and various standards, regulations and certifications of all kinds (technical, legal, environmental, sanitary, social, etc.). Coming on top of customs duties, all these non-tariff barriers (NTBs) further restrict access to markets and increase the real total cost of exports.

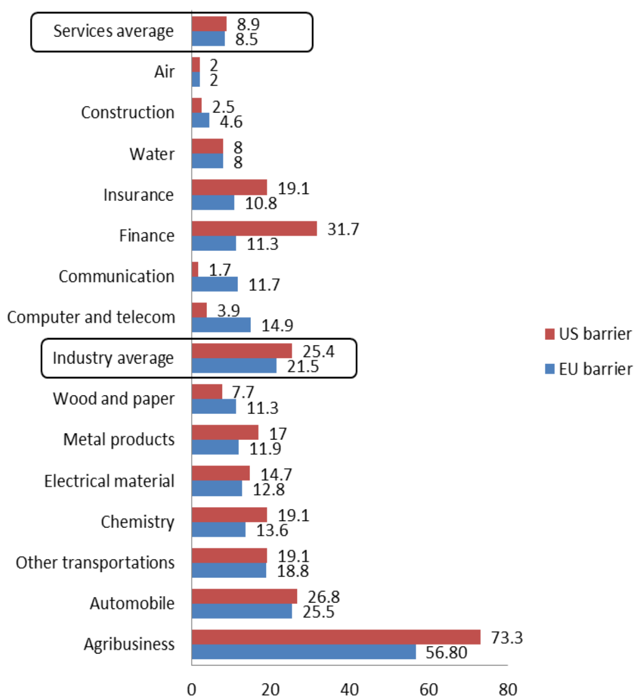
Adding all tariff and non-tariff barriers together reveals (***chart 3***) that the real rate of barriers is on average markedly higher in industry than in services (at least twice as high) and slightly higher in the United States than in the EU – unlike customs duties – although still with exceptions (construction, information and communication technology, wood and paper).

Chart 2 : Custom duties (comparison of rates for the main products)

	EU (a)	US (b)	spread (a)-(b)
Dairy products	57,6	19,2	38,4
Sugar and sweets	28,3	16,9	11,4
Animal production	24,3	2,4	21,9
Beverage and tobacco	21,8	16,3	5,5
Cereal	20,3	3,5	16,8
Clothing	11,5	11,4	0,1
Fish	10,9	1,0	9,9
Fruits and vegetables	10,4	4,8	5,6
Oleaginous, fat and oil	6,6	4,2	2,4
Textiles	6,5	7,9	- 1,4
Coffe, tea	6,2	3,2	3,0
Chemicals	4,6	2,8	1,8
Other agricultural products	4,4	1,1	3,3
Lether, shoes	4,2	4,3	- 0,1
Transportation equipment	4,1	3,1	1,0
Other end products	2,5	2,1	0,4
Electrical machines	2,4	1,7	0,7
Minerals and metals	2,0	1,7	0,3
Petroleum	2,0	1,4	0,6
Non-electrical machines	1,7	1,2	0,5
Wood and paper	0,9	0,4	0,5
Cotton	0	4,7	- 4,7
Average custom duties	5,2	3,5	1,7

Source : WTO

Chart 3 : Real rate for tarrif and non-tarrif barriers by sectors



Source : Ecorys Study for European Union

In this respect the automotive sector provides an interesting case. Industry players have decided to pre-empt a potential free-trade agreement by seeking to remove existing non-trade barriers between the different regions. CLEPA (the representative body for European automotive suppliers), AIAG (US suppliers) and JAPIA (Japanese suppliers) have already signed a memorandum of understanding in support of harmonizing technical and environmental regulations. Given that the EU exported only USD 37 billion to the United States in 2012 (including exports of automotive supplies), which was the same amount as Japan alone, and that the United States imports a total of USD 150 billion in cars, the growth potential for European countries therefore seems significant, in particular for the German automotive industry.

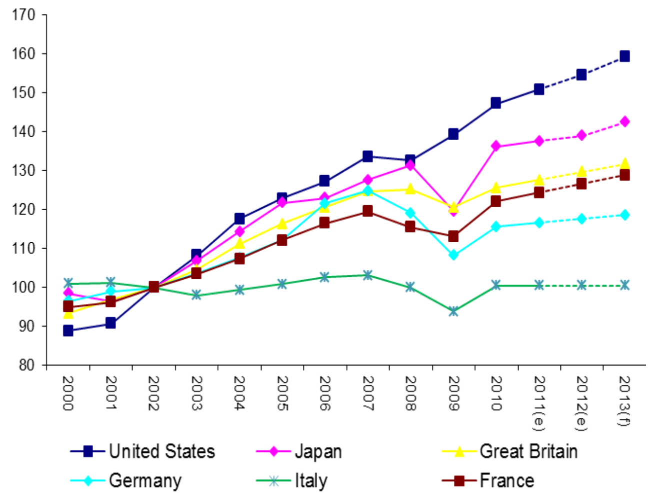
Although the agreement must be comprehensive, negotiations, which could get underway from the summer of 2013, look set to be delicate in light of (i) macroeconomic and competitiveness differentials in favor of the United States, and (ii) a number of sticking points, most often from the EU side

Negotiations could begin in the summer of 2013, after both parties leading the talks were given the green light (from the European Commission for the EU and Congress for the United States). The first stage will be to set the framework and scope of the negotiations, as well as a timetable. The European Commission President hopes to reach an agreement by the end of his term (November 2014).

The United States will begin the negotiations in a more favorable economic position, with better macroeconomic prospects and a competitive base that has been reinforced first thanks to the surge in productivity since the early 2000s (***chart 4***) and, more recently, thanks to the development of domestic shale gas extraction. The latter not only provides US companies with a cheap raw material relative to oil, but also penalizes European competitors in the same sectors and has changed the rules of the game for competing energy sectors. This gives the United States a head start to gain from a free-trade agreement in the chemicals sector: the production price per ton of ethylene, which was more or less the same on either side of the Atlantic in the early 2000s, has become 60% more expensive in the EU (***chart 5***). This has boosted investment in the United States, where production is expected to grow +20% by 2017 at the expense of the European plastics sector as a whole.

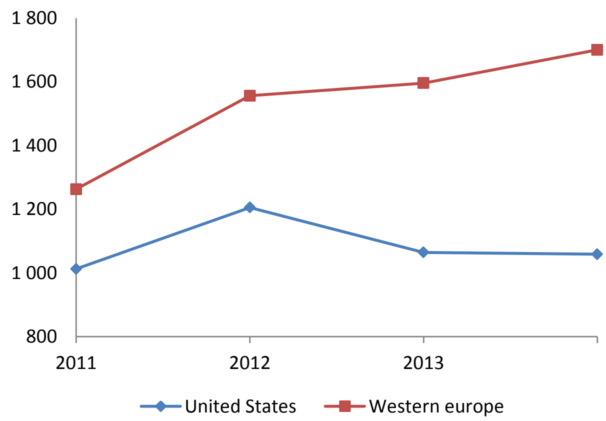
Competition rules in the wake of the shale gas revolution are not the only potentially tricky topic. In fact, there is a long list of potential stumbling blocks. Among the most important are the myriad agribusiness questions, including subsides granted to markets, restrictions on certain products, non-recognition of geographical indications, the use of GMOs and hormones, and sanitary rules.

Chart 4 : Evolution of productivity in the manufacturing sector (index base 100=2002)



Sources : Bureau of Labor Statistic, Euler Hermes

Chart 5 : Evolution of ethylene prices ($/ton)



Sources : Bloomberg, Euler Hermes

Chart 6 : The 2 most taxed sectors which could benefit from the setting up of a free-trading

	Sectors	Amount of exchanges (Bn $)
EU to United States	Textiles	2,7
	Agribusiness	16,1
United States to EU	Textiles	0,7
	Agribusiness	10,3

Source: WTO

Other sensitive topics include financial services, air and maritime transport, public procurement and systems of dispute arbitration and settlement, with the possibility open for companies to litigate against governments. Without doubt, the complaints made to the WTO between Boeing and Airbus could limit discussions on the aeronautics industry. In the end, some sectors could remain outside the agreement, in addition to those already excluded from the scope of negotiations such as defense and the audiovisual industry.

In the most ambitious scenarios, the free-trade agreement could not only provide up to USD 270 billion in additional trade per year out to 2027 but, as well as boosting growth, could also establish a new global standard for norms and regulations

According to a study conducted by the Centre for Economic Policy Research and commissioned by the European Commission, the projected agreement could bring in a further USD 88 billion to USD 150 billion per year for the EU, depending on how far tariff and non-tariff barriers are cut. Potential gains for the United States are estimated at between USD 63 and 120 billion per year out to 2027. The creation of this free-trade area therefore opens up the prospect of a boost to growth that the EU estimates at between 0.4 and 0.7 pp of GDP per year. However, as it encompasses 40% of global trade and GDP, such an agreement between the United States and the EU would not be without consequence for the rest of the world. This is the second aim of the agreement: to lead to greater standardization of norms and regulations not only to generate a fall in companies' production costs, but also to lay down a new global standard in the face of the rise of emerging countries and the proliferation of bilateral agreements.

Focus: The cultural exception

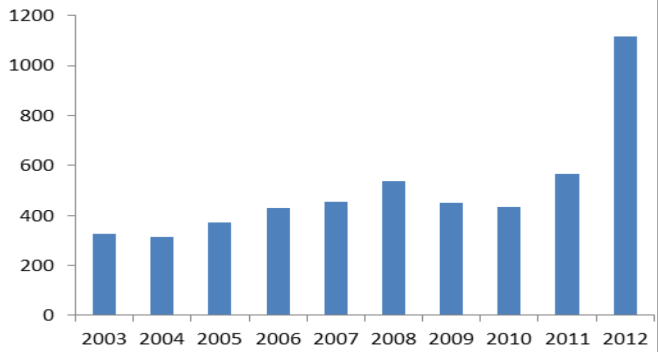
France places great importance on protecting its cultural industry from American dominance. It spends around USD 900 million per year in a system of subsidies that extend from artistic creation to the number of cinemas or theaters. France has nearly 5,500 cinemas, which makes it the fourth-largest country in the world in terms of equipment after China, India and the United States. This exception enables French production to retain more than 40% of market share compared with 43% for US films. Among other national film industries, this share is around 30% in Italy and the United Kingdom, and less than 20% in Germany. The market share of European cinema in the United States is structurally below 10%. French subsidies are considered necessary for the very existence of this activity, whose export ticket sales average less than USD 500 million (USD 1.1 billion in 2012 in what was an exceptional year), compared with nearly USD 24 billion for US films.

Chart 7 : Key figures of the cinema industry in the main European countries, in 2012

	admissions (million)	Evolution (%)	Share of national movies (%)	Screens	Visits index
France	203.4	-6.3	40.3	5502	3.3
United Kingdom	172.8	0.5	32.1	3817	2.2
Germany	135.1	4.2	18.1	4617	1.7
Italy	101	-9.9	26.5	3814	1.7
Spain	91.2	-7.3	19.3	4000	2

Source: National Center of Cinema

Chart 8: Foreign revenues of French movies (billion dollars)



Source: National Center of Cinema

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