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Prospects and Implications of a US-EU FTA

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Young gui Kim Head of Regional Trade Team, Department of International Cooperation Policy (ygkim@kiep.go.kr)
Yoo-Duk Kang Head of Europe Team, Department of International Cooperation Policy (ydkang@kiep.go.kr)
Kyeong Ah Lee Researcher, Regional Trade Team, Department of International Cooperation Policy (kalee@kiep.go.kr)

1. Why and how a US-EU FTA is being initiated

Ever since the 1990s, there has been a stream of unofficial studies and reviews discussing the possibility of a US-EU FTA. The average tariff rates for manufactured goods, however, in the US and EU are each a mere 2.0% and 2.4%, and both possess largely open economies. In this context it was generally accepted that a FTA between two parties would not bring about impact in terms of export growth. Accordingly, the US and EU have been concentrating on pursuing FTAs with emerging countries. In trade relationships with developed countries they have, meanwhile, focused on abolishing non-tariff barriers; they continued to discuss on liberalization in services and initiated several regulatory cooperations by industry, rather than on comprehensive FTAs. Key achievements in bilateral cooperation between the two sides are the US-EU MRA (1998), the EU-US Open Skies Agreement (2007) and the formation of consultative groups on different issues and industries under the auspices of the Transatlantic Economic Council.

Industrial circles from both sides have from time to time brought up the necessity of a US-EU FTA, but the feasibility of an actual agreement has been considered low.

However, the global financial crisis and the European debt crisis have led to the development of economic and political contexts that support the cause for a comprehensive FTA between the two economies. Such changes can be discussed in both internal and external contexts.

First, domestically, both the US and EU have been suffering from economic slowdown since the global financial crisis and the European debt crisis. Fortunately, the US is showing signs of recovery, but Europe, especially the Eurozone, is still in the slumps of recession. The most immediate way to boost the economy under such circumstances would be to implement expansionary fiscal policies, but a record amount of national debt is making it impossible to increase government spending, and base rates are also at a record low, leaving hardly any room for a policy mix. Expanding growth engines on the national level also has its limits, considering deleveraging of private debt and population aging (in the EU in particular). Against this backdrop, it has become a pressing necessity to expand external demand by boosting trade and investment. President Obama, European Commission President Barroso and the leaders of Germany, the UK and France (in a lesser extent) are all in strong favor of a US-EU FTA, and business organizations like the US Chamber of Commerce and Business Europe have also continued to advocate the idea in earnest.

External contexts are also changing in favor of the initiation of a US-EU FTA. The US and EU have, no doubt, been established as the two major pillars of the global community in terms of politics and the economy, but their places are being threatened by the rise of emerging powers like China, combined with the economic slowdown in developed countries. If the fiscal crisis and internal conflict leads the EU/Eurozone to dissolution or long-lasting stagnation, this is highly likely to weaken the global standing of the US. Therefore, the US needs Europe to maintain its economic strength in order to keep the rise of emerging countries in check, while Europe needs to forge a more solid trans-Atlantic relationship. It is in this context that some US media have dubbed plans for a US-EU FTA the "Economic NATO."[1] In terms of international trade, also, a US-EU FTA can contribute to reconstructing the global trade system around the US and the EU. For instance, if discussions on the FTA move ahead on a comprehensive level, covering trade in services, regulations, investment, intellectual property rights and government procurement markets, both sides can push the negotiation results as global agendas, thus gaining a stronger foothold within a multilateral framework.

2. How a US-EU FTA would affect the Korean economy

A. Impacts of tariff elimination

If tariffs between the US and EU are completely eliminated, Korea's exports to the EU are expected to drop by about USD 217 million, in cumulative terms, and exports to the US by about USD 167 million. In particular, exports to the EU are estimated to drop in the order of automobiles (∆USD 80 million), petroleum products (∆USD 13 million), automobile parts (∆USD 10 million), and other plastics (∆USD 9 million). Korea's key export items to the EU include ships, automobiles, and telecommunications equipment. Ship exports are not expected to suffer much from a US-EU FTA, for Korea holds a higher revealed comparative advantage (RCA) than the

[1] The Washington Post(2012. 12. 5).

US and the custom tariff applied to the US is relatively low. However, when it comes to automobiles, although Korea holds a comparative advantage to the US, the item itself accounts for a large part of both countries' exports to the EU, and US exports are currently subject to high tariff rates, which means a US-EU FTA may ignite competition between Korea and the US in the EU automobile market. Likewise, petroleum products account for a relatively large part of both countries' exports to the EU, and hold similar comparative advantages in Korea and the US, leading to expectations that a US-EU FTA will affect export competition between Korea and the US in the EU petroleum products market.

Table 1. US-EU FTA Developments

Date	Developments
Nov. 28, 2011	US-EU summit - The two leaders order the formation of the "High-Level Working Group for Jobs and Growth," represented by trade ministers from both sides.
Feb. 22, 2012	US Senate declares its approval of a US-EU FTA
June 19	Interim report from high-level working group (June 19, 2012) - Reaches conclusion that a Transatlantic Trade and Investment Partnership between the US and EU (hereinafter referred to as "US-EU FTA") is necessary, and recommends the inclusion in said FTA of tariffs, regulations and non-tariff barriers, services, investment, government procurement and intellectual property rights - Proposes that the US and EU adjust FTAs with third parties and provide a trade regulation guideline that can contribute to a multilateral trade system
Oct. 23	European Parliament declares its approval of a US-EU FTA (Oct. 23, 2012) - European Parliament delegates negotiation rights to the EU Commission so that FTA negotiations can begin in the first half of 2013
Feb. 8, 2013	EU leaders agree at the EU summit to actively pursue an FTA with the US
Feb. 11	Final report from high-level working group (Feb. 11, 2013) - Proposes three key sectors for the US-EU FTA: Market access (Sector 1), regulatory issues and non-tariff barriers (Sector 2), and international trade regulations and next-generation cooperation (Sector 3) - Stresses that Sector 1 will be on a similar level as other FTAs, but the focus should be on Sector 2 and will include SPS plus and TBT plus, covering a higher level of agreements compared to other FTAs - The purpose of Sector 3 is to globalize the US-EU FTA's contents, adjusting FTAs with third parties and contributing to multilateral trade systems
Feb. 12	US President Obama declares plans for US-EU FTA official in State of the Union address
Feb. 13	FTA negotiations are officially announced to be in motion in joint statement between EU Commission President, European Council President and US President

Source: Data compiled from information released by major press media and government agencies of relevant countries

Meanwhile, exports to the US are expected to fall in the order of petroleum products (∆USD 30 million), automobiles (∆USD 30 million), tires (∆USD 9 million) and automobile parts (∆USD 5 million). Korea's key export items to the US include telecommunications equipment, automobiles and automobile parts. Exports in telecommunications equipment will not be much affected by a US-EU FTA, for Korea holds a higher comparative advantage to the EU, and tariff rates applied to the EU is low. Automobiles and petroleum products, however, are similar in comparative advantage to the EU, and account for a large part of both economies' exports to the US, making it likely for the two to become export rivals in these sectors.

Table 2. US-EU FTA Impacts on Exports

(Unit: USD 100 million)

Scenario*	Exports to the US**	Exports to the EU***
Agriculture	△0.03	△0.01
Manufacturing	△1.64	△2.16
Total	△1.67	△2.17

Note: *100% tariff elimination. Food included in agriculture.
**Exports to the EU: USD 49.379 billion (2012), USD 55.727 billion (2011)
***Exports to the US: USD 59.524 billion (2012), USD 56.208 billion (2011)

A US-EU FTA is expected to bring Korea's real GDP down by 0.02~0.05%, and welfare levels down by USD 431 million to 519 million, according to the extent of tariff reduction.[2] Lower tariffs between the US and EU following are also likely to lead to Korean's economic slowdown by a drop in Korea's exports to both markets as well as indirectly by a fall in China's exports to the US and EU. However, the FTA will pose limited damage to the Korean economy, since more trade between the US and EU can lead to higher demand for Korea's intermediary goods, and the entire global export market will expand in the mid to long term.

Domestic industries will undergo a general decline in production in the mid to long term, but changes will differ by industry. While textiles (△0.01~△0.1%), chemicals (△0.04~△0.07%), automobiles (△0.22~△0.34%), and transport equipments (△0.17~△0.34%) are expected to witness production decline, industries that will likely enjoy higher demand for intermediary goods, like the steel (0.02~0.07%), metal (0.11~0.15%), electronics (0.08~0.14%) and machinery (0.1~0.19%) industries, can look forward to increased production.

B. Impacts of relaxed non-tariff barriers and improved regulations

In line with the impacts of tariff elimination, the impacts of trade boosts between the US and EU induced by relaxed non-tariff barriers or Regulatory harmonization and compatibility improvements are expected to cause trade diversion. While the average tariff between the US and EU stands at 3~4%, non-tariff barriers are extremely high, ranging from 25.5~73.3% in food and beverages, cosmetics and automobiles. Therefore, the elimination of non-tariff barriers may actually cause more damage to Korea than the elimination of tariffs. It has been analyzed that the complete elimination of non-tariff barriers in a US-EU FTA will lead annual exports to rise at an average rate of 2% and 6% from 2008 until 2018, in the EU and US, respectively, foreshadowing damage from

[2] Scenarios were drawn up on the premises that current tariff rates are cut by 90% to 100%, and analyze the impacts of the US-EU FTA under conditions that the Korea-US and Korea-EU FTAs are already in effect.

trade diversion for Korean companies.[3]

At the same time, however, it is possible that Regulatory harmonization and improved compatibility between US-EU regulations may lower regulatory compliance costs for Korean companies, thus working in favor of Korea's utilization of the Korea-US and Korea-EU FTAs. Additional costs incurred by regulatory differences in trade between the US and EU reach the tariff equivalent of 10~20%, which is a considerable obstacle. In particular, the two economies are aiming to cut unnecessary costs and administrative delays by improving regulatory compatibility in chemicals, automobiles, and medicine and medical supplies.[4] Regulations for automobiles, Korea's key export item to the US and EU, currently differ by country, and if these regulations are harmonized and made compatible, Korea can hope for a positive external effect following the reduction of unnecessary overlapping costs.

3. Prospects and implications

A. Prospects

The US-EU FTA negotiations are set to begin in the first half of this year. Political and industrial circles from both sides are expressing their strong approval of the FTA, and a joint statement has officially confirmed that negotiations will soon commence. Since the Council of the EU has already delegated negotiation rights to the European Commission, negotiations are expected to start once procedures in the US (official notice to Congress followed by a 90-day consultation period) are complete. It is highly probable that the deadline for settling negotiations will set to before October, 2014, when the current European Commission's term of office ends. If this deadline is not met, the next target date for conclusion is forecast to be within the US president's current term of office (end of 2016).

Considering recommendations in reports from high-level working groups or the status of both economies within the WTO, both sides are expected to aim for the conclusion of a comprehensive agreement. According to working group reports, the agreement will include content on market access,[5] regulation issues and non-tariff barriers,[6] and international trade regulations.[7] Considering similar cases from the past, negotiations are likely to proceed by sector rather than on a comprehensive level, and it is highly probable that the talks on eliminating non-tariff barriers and tuning regulations will involve sectoral negotiations to reflect the demands of industries. If the target is to conclude negotiations by 2014, the process is likely to be divided into two stages, the first stage covering market access issues, and the second discussing the comprehensive agreement centered on the built-in agenda. The two sides are expected to lock horns over regulations on food and chemicals,[8] and agricultural subsidies, and judging from the examples of other FTAs, the overall settlement of a com-

[3] ECORYS (2009), "Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis," p.xix, xx.

[4] European Commission (2013) (MEMO/13/95), "European Union and United States to Launch Negotiations for a Transatlantic Trade and Investment Partnership," p. 1, p. 2.

[5] Products, services, investment, public procurement

[6] Behind-the-border barriers like safety /environmental regulations (automobiles, etc.), cross recognition of standards and procedures (SPS, TBT), regulatory compatibility (chemicals, automobiles, medicine and medical supplies)

[7] Intellectual property rights, environment and labor, and other issues (trade facilitation, competition, state-owned companies, etc.)

[8] US regulations tend to focus on the final product, while EU regulations generally cover the entire value chain, and this leads to large institutional differences in food, chemicals and cosmetics.

prehensive FTA will take more than two years, and the implementation of the concluded FTA will also take considerable time. It is therefore likely that negotiations will first start off with the issues of tariff elimination and regulatory easing in the manufacturing sector, which can be concluded early within the set timeline, and are expected to reap tangible achievements. Issues that require long-term negotiations will be included in the built-in agenda, as a means to keep up the momentum in the form of a "living" agreement.

B. Implications

The US-EU FTA is expected to make a considerable impact on international trade, not only through its conclusion, but also through the process of negotiation. First of all, since plans are to include regulatory issues and global trade rules in the FTA, the content of the agreement is likely to develop into guidelines for global trade governance. The US and EU are currently leading global competition on regulations, and it is clear that these two entities will be able to solidify their global status if their regulations converge or achieve mutual recognition. Second, the provision of guidelines for global trade regulations may spark some action in efforts to pursue plurilateral agreements, and may also stimulate emerging developing countries, reviving the drive to push ahead with the stalled WTO DDA negotiations. Third, the two entities are expected to try adjusting each other's FTAs with third parties, and this process will realign FTAs around the US and EU, leading to a ripple effect on FTA policies across the world. If this adjustment procedure moves ahead as both sides hope, a worldwide standard framework for FTAs will be established.

An interesting development is the US's recent FTA strategies. The underlying strategy for the TPP would be to secure the initiative for economic integration in the Pacific Rim, while the US-EU FTA would the strategy for economic integration in the Atlantic Rim. Such active FTA strategies are expected to expedite economic integration discussions in the East Asian region. In particular, since it is yet unclear whether China will join the TPP, the country would naturally be concerned that the US-EU FTA could lead to weaker market access and less influence. Therefore, it is highly probable that China will take an active stance toward pursuing FTAs. This is expected to add momentum to negotiations on the Korea-China FTA, of which the fourth round of negotiations took place in October, 2012, and on the Korea-China-Japan FTA, of which the preparation meeting was held in February, 2013,

It will take considerable time before the US-EU FTA officially goes into effect, but partial agreements may take effect earlier than expected if negotiations are divided into different parts. Korea should quickly prepare for such possible early conclusions by raising utilization rate of tariff preference given by FTAs already in effect. As Korea has already entered separate FTAs with the US and EU, it is necessary to design a strategy that would utilize both FTAs as a whole when pursuing investment abroad. It is also necessary to keep an eye on how the Korea-US and Korea-EU FTAs will be affected in the course of discussions between the US and EU on adjusting each other's FTAs. The US-EU FTA is expected to include the highest level of market access among all FTAs concluded by both sides. It will be therefore necessary for Korea to conduct a preliminary review of whether the future most-favored-nation treatment principle can be applied in the framework of both Korea-US and Korea-EU FTAs. KIEP