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# The golden opportunity – Is the enlarged Europe ready for the Transatlantic Free Trade Area?

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**Content**

## 1. Transatlantic Economic Relations – Little Change in the Ever-Changing World Affairs

The world economy grows together. When Japan and the East Asian Tigers Taiwan, Hong Kong, Singapore and South Korea entered into the global economy exchange of goods few years ago, the whole world waited for the consequences with bated breath. Since then, new economies like China and India forge ahead in the world economy. The integration of these two countries in the world market will be an enormous challenge for Europe and the United States. But what about Europe and the United States themselves? Regarding the possible consequences of the modified economic relations in the world, a strong economic alliance would be the best safeguard from the expected changes in the global economy. Bilateral agreements are the new big deal in economic relationships between states and they are still a big deal in the transatlantic relationship. Europe and the U.S. do not have long historical economic connections - the economy has got a preferential status in the transatlantic relations not until the Fall of the Berlin Wall – but with the triumphal procession of the globalization, transatlantic economic relations have become a foundation for the development of the biggest economic area in the world.

Today, Europe and the United States have the strongest economic relationship ever. They combine 40% of the gross domestic product worldwide and more than one third of the world trade at all. Every day, the exchange of goods and services of about 1.7 billion euro takes place. The transatlantic trade market is brisk: it doubled from 273 billion dollar in the year 1990 to 557 billion dollar in the year 2000.[i] Since the year 2001, the transatlantic trade market has been constant and amounts about 400 billion euro a year[ii], despite the Eastern Enlargement. In 2005, exports from the EU to the U.S. amounted to 250 billion euro (23.7% of the total EU exports), while imports from the U.S. totaled to 163 billion euro (13.86% of the total EU imports). Similarly the Foreign Direct Investments (FDI) from US companies in Europe and vice versa act as a good indicator for the meaningfulness of the transatlantic relationships. In the year 2004, the total amount of two-way direct stock investment was 1.5 trillion euro[iii].

### *1.1 Euro Euphoria and Dollar Volatility*

Although the figures given pretend the EU-U.S. economic relationship being presentable, a few difficulties become apparent. One problem is that the global developments, that are most likely to influence the FDI decisions, are the recovery of the U.S. Economy and the dollar volatility[iv]. The U.S. economy is losing its global dominance. The share of global exports purchased by U.S. consumers and business fell to 17.9% in 2005 from 21.8% in 2000[v], caused by an increasing demand in the European Union, Japan and the Asian states. At the same time, there is no expectable run on the dollar to improve the present dollar condition. This could negatively affect transatlantic Foreign Direct Investments. In addition, it seems that Europe and Asia are trying to find their way into the world market with trade agreements that do not include the United States. In September 2006, the European Union signalized that it would have bilateral trade deals with China and South Korea. The European Union is going to have the fastest growth this year since 2000 and Germany plays a decisive role as the largest economy in Europe. Jean-Claude Trichet, the European Central Bank president went to such lengths to say: "As regards trade links, the United Kingdom is more important for the euro area than the United States"[vi]

On the other side, the EU should face up to the facts that slowing global demand and a stronger euro are severe risks for economic growth in the European Union. The French IFRI-institute published a study in May 2003, which exemplified that the EU could lose their share in the world market from 22% at the moment to 12% in the year 2050. The reason is the decrease of the active population in the European Union from 331 million in the year 2000 to 243 million employees in 2050[vii]. "The big question now, of course, is how long can the euro zone recovery continue?"[viii] says Jonathan Loynes of Capital Economists facing the European figures topping those of the United States on the one hand and on the other hand the problems a strong euro can cause for the European economy. A hard currency costs European exporters sales because their goods become more expensive abroad. Of course in reality this calculation is offset by a range of different factors, but the European Central Bank seems willing to tolerate the further rise of the euro. Nobody knows how long the dollar will swing and in this regard how long the United States remains the no.1 importer by far, buying 1.7 trillion dollar in goods and services from the rest of the world last year, according to the Economist Intelligence Unit, a London-based research company[ix].

*1.2 Eastern Enlargement – Transatlantic Enlargement?*

A few rising stars lie quiet amidst the new European states. Combining good luck and good policies, the two Baltic countries Estonia and Latvia reached growth rates 11.6 % and 10.9% in 2006, a respectable figure even compared to the states in East Asia[x]. Economists call Estonia the Baltic tiger, because Estonia was in first place in the last year's Liberty Index, a ranking of countries by their economic and political freedom[xi]. It is the mix of good government, balanced budgets, a simplified tax structure and stable currencies that makes Estonia's and Latvia's development a success story. Nevertheless, joining the euro will be a big challenge for the Baltic countries. Estonia and Latvia defy the odds that they have huge current-account deficits (Latvia: 17.9% of GDP; Estonia 12.5 % of GDP) and that their currency boards give the two countries no independent control over interest rates. Yet they still run big budget surplus. Joining the euro could have inflationary implications for their economies[xii]. For comparatively poor economies, trying to catch up on the standard of the European Union could dampen their enthusiasm and eventually their economic growth.

In addition, expanding the euro to the new Central and Eastern European States does not go according to plan. Slovenia will join the currency next year, but as suggested the other states have doubts if the euro would really bring them advantages or instead just minimize their growth rates. The big question is, whether the new states should not wait until their economies converge more closely to the rest of the euro zone. The euro is getting stronger and stronger, but the in reality it has provided no obvious benefits to the 12 countries that use it[xiii]. It seems that the currency is not the essential key to economic success. Estonias star politician, Mart Laar says it right when he proclaims: "happiness does not lie in money"[xiv]. The European Union's newest member states arrange their economical affairs in a special way. But the EU has not realized this point and reacted yet. This requires a rethinking in the European Union, especially in economic relationships.

Hence, for the transatlantic relationship, the Eastern Enlargement is not really world-shaking. The economies of the new member states are too fragile, narrowed and in spite of the huge growth rates in the Baltic corner, they are neither reliable nor predictable for future investments. But if the signs remain excellent and the European Union does not initiate the euro before the new members demonstrate their economic strength, companies from the United States could possibly explore the new European member states as investment goldmines.

**2. How to fix the Transatlantic Economic Relationship**

Regarding the diverging ways the European Union and the United States act in the political international area, the economic strength between the two countries seems to be something both should appreciate. It provides a basis for a prosperous perpetuation of transatlantic relations from now to the future.

The main point is the discussion about a Transatlantic Free Trade Area or short: Tafta. Core elements of the Tafta would be a common regulatory policy, code of competition law and support for open and competitive capital markets. To achieve this, it is important to harmonize accounting practices and the delisting provisions applicable to U.S. stock markets and furthermore jointly to regulate hedge funds that operate globally. Tafta could also be an impulse for an exchange of innovation and research in fields like energy production or environmental protection. Matthias Wissmann, Member of the German Bundestag and chairman of the parliamentary committee for European Union affairs, aims for the completion of the transatlantic market by 2015 while targeting 2010 for the harmonization of financial services and capital markets[xv]. The result could be a GDP increase of almost 3 percent in the European Union and almost 2 percent in the United States. But it is not all about the money. “The creation of a genuine transatlantic market can become a new flagship project for the European Union”[xvi], says Wissmann. Anymore the Tafta could even reinvigorate the EU that has been paralyzed by the crisis over the Constitutional Treaty. They say that the German Chancellor Angela Merkel has similar thoughts about the Tafta, trying to present Tafta as a new incantation for strengthening the transatlantic relationships. For this reason Merkel initially was going to make Tafta an item of the agenda of the next German presidency of the Council. Her argument is obvious: Why should we not eliminate the present trade and customs barriers to bring economic wealth to the population in both regions?

## 3. A Volitional Protectionism

The answer on this question is banal: because the European Union and the United States are not really interested in doing it. The idea of a Transatlantic Free Trade Area is not a new one. In the year 1994, the Canadian commerce secretary Roy MacLaren first made proposals about a Transatlantic Free Trade Area. German’s foreign minister Klaus Kinkel adopted the idea and brought it forward before, at that time, the EU-U.S.-summit had started. The consequence was an agreement about extensive elimination of trade barriers and the intensified trade in goods, services and funds, but neither Europe nor the United States have really thought about a bilateral free trade area. In 1998, Europe’s commerce commissar Leon Brittan had stalwart plans about the TAFTA, but what he did not have was a plan of how to smooth out the distrust not only between the European Union and the United States, but also between the particular member states of the EU. Especially France has seen essential interests jeopardised, because of the potential influence of the United States on the French culture, media and – what else – the agriculture.

Another try to implement a Transatlantic Free Trade Area were the New Transatlantic Agenda (NTA) and the Joint EU-U.S. Action Plan. The NTA had been passed 1995 during the summit conference in Madrid and envisioned a deepening of the cooperation, amongst others in the competition law and the reciprocative authentication of standards and certifications. Almost ten years later, 2004, the European Commission ordered an independent study about the course of the NTA[xvii]. The appraisal of the results is disillusioning: chances of the NTA to inspire the dusty transatlantic economic relations failed. The main deficiency of the previous process has been an absence of political commitment and assistance.

Today, the transatlantic partners are still arguing about the same problems as in the years before. But the view at the problems has changed. It is not just economy anymore. As everything else during the process of changing international relations in a globalized world, economic relations became part of the strategic plan of the United States as well as of the European Union. And this is the greatest chance and the greatest danger for a Transatlantic Free Trade Area. Looking at the three biggest strategical conflicts of the transatlantic economic relationship, the Airbus-Boeing-Conflict about the subsidization of civil airplanes, the European satellite navigation system Galileo and the annihilation of the European arms embargo on China, there is one joint element: the insuperableness of the core problem, which lies in every of these topics. The United States will not decrease the pressure on the European Union to stop the subsidization of Airbus because with the success of Airbus, the European Union has stoked fears of the United States to lose what they regard to be very important for their country: their military predominance. The connection of military and civil aviation is of huge strategic importance for both companies and their governments[xviii]. With Galileo, the satellite navigation system, it touches the same tender spot. Galileo is primarily designed as a very accurate navigation system, but of course with its advanced technology, it can be used for military purposes[xix]. Its dual-use qualities and the fact that, in addition, the European Union has concluded an agreement with China about cooperation and financial holding of Galileo, has lead to confusion in the transatlantic economic relationship. The last controversial subject, the abolishment of the arms embargo on China shows at forthright the dimension of the dispute between the European Union and the United States. Here, it is not just the fear of possible military clashes and the European assistance in US-Chinese-conflicts. Chinas technology sector is emerging faster than the US is likely to accept it. The European Union could export more advanced technology to China, which China could possibly use in a military way. The logical consequence would be an improvement of Chinese technology and thus a closing margin of U.S. in miliary dominance. If the dispute reaches this point, the European Union would lead the United States up to the garden path. Being economical partners means being trustworthy. “Expanded economic relations and a substantial amount of investments are at stake if it won´t be possible to avoid a tariff war” says Thomas Bauer from the Munich Center for Applied Policy Research (C.A.P)[xx]. But how to bring the transatlantic economic relationship in line with these challanges?

**4. To trade or not to trade – that is the question**

Facing the unwillingness of the transatlantic partners to solve their problems by creating a free trade area leads to political inability to illuminate the transatlantic economic relationship through deepening the institutional domain in economic relations. Both regions, the United States and the European Union, are too much involved in domestic troubles like the European constitutional crisis or the U.S.-war in Iraq, to be really aware of the advantages they are about to lose, when they neglect the bilateral economic relations. And both states are taking the easy way. During the last years, the United States have concluded 15 free trade agreements beside NAFTA, thereof 13 during the presidency of George W. Bush. Most of them were negotiated with Asian states and states in Latin America, because these agreements seemed to yield the most profit for the United States. The same happened in Europe with the new member states in Central and Eastern Europe during the Eastern Enlargement. The latest plan of George W. Bush has been the implementation of a Pacific-wide free trade zone that would encompass half of the world trade. At the Asia-Pacific Economic Cooperation Forum in November this year, Leaders and business executives discussed an alternative in case the WTO´s Doha round of trade talks never gets back off the ground. The United States, New Zealand and a business council that advises APEC urged Asian leaders to set up a Free Trade Area of the Asia-Pacific (FTAAP).

It is difficult to compare the trade agreements. In the meantime it becomes clear that the amount of a trade agreement draws a distinction. What George W. Bush is planning to create -

the FTAAP - is a Free Trade Area that would cover 40% of the world's population and 56% of its gross domestic product[xxi]. Mini trade agreements are not enough, concludes the top-management consulting company A. T. Kearney in their "FDI Confidence Index" from October 2004[xxii]. "Much of the low-hanging fruit from past trade liberalization has been harvested. What remains for further liberalization are among the most difficult and contentious issues, such as intellectual property rights and agriculture"[xxiii] the Index finalizes. What Europe and the U.S. should also keep in mind is that within Asia, the number of trade deals is soaring. The ten ASEAN countries have bilateral deals with each other and all have bilateral deals with China. Regarding just East Asia, there were about 70 free-trade deals by the end of 2006[xxiv].

## 5. Healthy competition

The European Union and the United States should finally realize that their economic relationship is at the crossroads. The disputes between Europe and the United States are irresolvable in the view of the special global political and economical situation. It would be foolhardy to believe that the transatlantic partners will lose their problems with the "Dispute Settlement Understanding" within the WTO. Even worse, "going to the WTO-arbitration do harm both sides more than bringing them a solution"[xxv]. Waiting for the Doha trade talks to continue means a waste of time, facing the outstanding prosperities of global trade talks. Disappointing but true: the WTO is not helpful to strengthen the transatlantic economic relationship.

### *5.1 Get ready for the Transatlantic Free Trade Area*

Finally, it is the turn of Europe and the U.S. to act. They need a Transatlantic Free Trade Area. Not because Tafta is inescapable. The economical advantages would be considerable but not outreaching. Between the European Union and the United States, customs duties on industrial commodities are about 4% and therefore the lowest in the world trade. Even if eliminating higher customs duties on agricultural products, the income effect would just amount to 0.3% of the gross domestic product of both regions[xxvi]. But nevertheless, the European Union and the United States need Tafta. They need a signal for the future advancement of the transatlantic economic relationship. And Tafta would be a political symbol for a deepened economic relationship. It would compensate the lack of credibility within the transatlantic partnership and bring this topic back to the consciousness of European and American policy as well as return it to the public eye. Tafta could sanitize the public image of the transatlantic relationship while attracting notice to the marvellous transatlantic economic relations. It is important to demonstrate the people how much economic relations influence everyday life in spite of global differences. And this is what the European Union and the United States have not realized yet. A Transatlantic Free Trade Area could help them to reconcile their differences just because the free trade area exists. It should be an incentive for the transatlantic partners to attend to their disputes, not to beat around the bush. Certainly, the problems cannot be solved overnight, but with a bilateral agreement, the EU and the US would have a forum, if not an obligation, to resolve their misunderstandings.

### *5.2 Mark of Recognition*

A Transatlantic Free Trade Area is a chance for the EU to be on a par with the United States. It offers the European Union an opportunity to act strategically, something the EU has not had the heart to do yet. But strategic alignment is what provides a long-term competitive advantage, not just in economical ways. Good economical relations and on this note a Transatlantic Free Trade Area enable the European Union to align with the United States and other global trade partners like China. It could balance the world trade powers by being one of them. The last clash at trade talks between the U.S. and China happened during a two-day dialogue on economic issues on 14th and 15th of December 2006. While the U.S. trade representative Susan Schwab said, that “the Asian model of basing economics on state control and huge amounts of exports was no longer suitable for China, which now must focus on domestic consumption rather than exports to achieve growth”, Chinas deputy prime minister Wu Yi was arguing that the Chinese policies had the “genuine feeling that some American friends are not only having limited knowledge of, but harbouring much misunderstanding about, the reality in China”[xxvii]. Here the European Union can play an important role and bring the both sides together. So far the European Union has not been biased and can show its strengths best by helping the United States to rearrange their relations with China. The European Union would help them understand, where critical issues are and thus deepen their relation with the United States. To keep in mind, China is highly interested in preserving the good economical relations with the European Union. Tafta will not really change this appraisal.

How easy the transatlantic relationship work in some way can be seen at the fusion of Euronext and New York Stock Exchange (NYSE) to the first transatlantic stock market on the

20th December 2006. Although there has been a lot of criticism in the run-up, finally the fusion proceeded smoothly. The fusion is a logical consequence of globalization. Along with the Investors, the market places are also getting global. In the end, this is what counts for the European Union and the United States: Think global, act local. And act local means in this case: act transatlantic.

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