



# U.S.-EU Trade and Economic Relations: Key Policy Issues for the 112<sup>th</sup> Congress

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## Summary

The 112<sup>th</sup> Congress, in both its legislative and oversight roles, confronts numerous issues that affect the trade and economic relationship between the United States and the European Union (EU). As U.S.-EU commercial interactions drive significant job creation on both sides of the Atlantic, Congress is monitoring ongoing efforts to deepen transatlantic ties that are already large, dynamic, and mutually beneficial.

U.S. and European private stakeholders, concerned about slow growth, job creation, and increased competition from emerging economies, have urged Brussels and Washington to strengthen transatlantic trade and economic ties by reducing or eliminating remaining trade barriers and by cooperating more closely in addressing global economic challenges. A number of studies produced over the past several years have called for new bilateral trade, investment, and other economic arrangements to maximize economic opportunities available to stakeholders on both sides of the Atlantic.

At the November 28, 2011, EU-U.S. Summit meeting, leaders from both sides directed the Transatlantic Economic Council (TEC) to establish a High Level Working Group on Jobs and Growth. The Working Group, which will be led by U.S. Trade Representative Ron Kirk and EU Trade Commissioner Karel de Gucht, was tasked with assessing options for strengthening the U.S.-EU trade and investment relationship, especially those that have the highest potential to support jobs and growth. The findings and recommendations of the Group are due by the end of 2012. The Working Group will provide an interim update to Leaders in June 2012.

There are many options the Working Group could explore for greater liberalization of the transatlantic economic relationship. They range from a comprehensive and traditional free trade agreement to parallel but separate negotiations in areas such as elimination of tariffs on trade in goods, liberalization of services trade and foreign investment restrictions, and reduction of regulatory barriers. A select group of these issues, including enhanced bilateral cooperation on global issues, is discussed in this report.

Despite generally low tariff levels on both sides, some in the U.S. and EU business communities support negotiating the elimination of all remaining tariffs imposed on U.S.-EU trade through a bilateral negotiation. Support for a zero-tariff agreement is based on a combination of factors, including the agreement's ability to generate economic benefits for both sides and the leverage such an agreement could create for pressuring emerging economies to make more concessions in the Doha Round of multilateral trade negotiations. Consideration of enhanced regulatory cooperation and one or more bilateral agreements addressing investment and services trade issues are also being touted by the business community.

Greater collaboration and alignment of U.S. and EU approaches towards addressing global economic challenges, such as completing the Doha Round, dealing with China's trade barriers, and reducing global imbalances, remain a work in progress. Given shared interests in opening emerging markets further to industrial goods and services, business interests have urged U.S. and EU negotiators to work more closely together to press other countries for more concessions. EU negotiators in the past have remained reluctant to move in this direction perhaps out of concern that greater ambition would require further EU concessions on agriculture.

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## Introduction

The United States and the European Union (EU) share a large, dynamic, and mutually beneficial economic relationship. Not only are trade and investment ties between the two partners huge in absolute terms, but the relative importance of bilateral trade and investment flows for each partner has remained high and relatively constant over time, despite the rise of China and other Asian economies.<sup>1</sup>

The EU as a bloc is the United States' largest merchandise or goods trade partner of the United States. As shown in **Table 1**, the EU accounted for 17.5% of U.S. merchandise trade in goods in 2010. Canada, the second largest trading partner, accounted for 16.5% of total U.S. merchandise trade. The EU is also the largest purchaser of U.S. exports of services, accounting for \$170.2 billion (or 31.0% of the total in U.S. services exports to the world) in 2010.

**Table 1. U.S. Trade in Goods with Top Five Partners, 2010**  
(billions of dollars)

Partner	U.S. Exports	U.S. Imports	Trade Turnover	% of U.S. Trade
EU-27	239.6	319.2	558.8	17.5
Canada	249.1	277.6	526.7	16.5
China	91.9	364.9	456.8	14.3
Mexico	163.5	229.9	393.4	12.3
Japan	60.5	120.5	181.0	5.6
World	1,278.3	1,913.2	3,191.5	100

**Source:** U.S. Department of Commerce, Bureau of Economic Analysis; *U.S. International Accounts Data*; <http://www.bea.gov>.

**Notes:** Trade turnover is the sum of U.S. exports and imports.

The importance of the EU is even greater on the foreign direct investment side, where European companies accounted for \$1.5 trillion, or 63%, of total foreign direct investment in the United States and U.S. companies accounted for \$1.7 trillion, or about 50%, of total foreign investment in Europe in 2009. These investments account for four million workers on both sides of the Atlantic being directly employed by the respective affiliates of U.S. or European-based companies. The German company Siemens, for example, employs some 60,000 people in the United States and General Electric employs some 70,000 workers in Europe.<sup>2</sup>

<sup>1</sup> The European Union is comprised of 27 member states: Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. For background on the European Union, see CRS Report RS21372, *The European Union: Questions and Answers*, by Kristin Archick and Derek E. Mix.

<sup>2</sup> CRS Report RL30608, *EU-U.S. Economic Ties: Framework, Scope, and Magnitude*, by William H. Cooper.

The U.S.-EU trade and investment relationship, what many call the transatlantic economy, is not only the largest in the world but also arguably the most important because of its sheer size. As shown in **Table 2** the flows of merchandise or goods trade, services trade, and income across the Atlantic manifest a very active, strong, and large economic relationship. In 2010 alone a total of \$1,537.4 billion flowed between the United States and the EU, or an average of \$4.2 billion per day.

**Table 2. U.S. Current Account Balance with the EU, 2010**  
(billions of dollars)

Transactions	Totals
U.S. Exports of Goods and Services	412.8
U.S. Imports of Goods and Services	666.2
U.S. Income Receipts (derived from U.S. assets, including direct and portfolio investments and government securities)	247.8
U.S. Income Payments (derived from EU assets, including direct and portfolio investments and government securities)	205.5
Total Current Account Flows	1,537.4
Daily average flow based on the current account	4.2

**Source:** U.S. Department of Commerce, Bureau of Economic Analysis; *U.S. International Transactions Accounts Data*; . <http://www.bea.gov>.

**Notes:** The current account is the most comprehensive measure of U.S. international trade and financial transactions with the world. Net unilateral transfers (government grants, pensions, and private remittances) totaling -\$4.6 billion are not included in this table.

With a combined population slightly over 818 million or about 12% of the world’s population, the two partners produce around 50 percent of the world’s GDP. Combined with bilateral trade flows in goods and services that account for 40% of the world total, the magnitude of transatlantic economic transactions means that the two sides have significant influence and leadership responsibilities in the world economy. Agreement and cooperation between the two partners in the past has been critical to making the global trading system more open and efficient.

The high degree of transatlantic economic interdependence, however, carries some downside risks, as demonstrated by the 2008 financial crisis, which started in the United States and was then transmitted to Europe. As the U.S. economy is now recovering from the deep recession, EU members Greece, Ireland, Portugal, and Spain are struggling to address sovereign debt crises which are slowing Europe’s economic growth and recovery. With a significant stake in European economic growth, there is a concern that U.S. exports may be adversely affected at a time when the Obama Administration hopes to double US. exports by 2015.<sup>3</sup>

Given the magnitude of commercial interaction, trade disputes are not unexpected. Policymakers tend to maintain that the United States and the EU always have more in common than in dispute, and like to point out that trade disputes usually affect a small fraction (often estimated at 1-2

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<sup>3</sup> CRS Report R41411, *The Future of the Eurozone and U.S. Interests*, coordinated by Raymond J. Ahearn.

percent) of trade in goods and services. Both sides have been working to resolve some of the biggest disputes for years. These include a dispute between the aerospace manufacturers, Airbus and Boeing, and conflicts over bio-engineered food products and protection of geographical indicators. The Airbus-Boeing dispute involves allegations of unfair subsidization for both companies and is being adjudicated by the World Trade Organization dispute resolution process. The agricultural-based disputes are rooted in different approaches to regulation, as well as different social preferences.

U.S.-EU trade and economic relations are also characterized by other forms of competition and rivalry. Each side aspires to lead in setting rules for global trade and investment, often in an effort intended to facilitate commercial success for its respective companies. Similarly, both economic powers often compete to secure bilateral and regional trade agreements to support jobs, markets, and foreign policy interests. No where may this be more apparent than in the EU's rush to negotiate a free trade agreement with South Korea following the negotiation of the U.S.-South Korean FTA in 2007.<sup>4</sup>

While the U.S. and EU economies are very open to trade and investment flows from both sides, some barriers to trade and investment remain. Various studies, in fact, estimate that substantial economic gains in terms of jobs and faster growth could be attained if progress was made in reducing a range of remaining tariff barriers at the border and regulatory "behind the border" non-tariff barriers.<sup>5</sup> Private stakeholders on both sides have urged policymakers to cooperate more closely to reduce remaining barriers to trade and to provide greater leadership for the world economy. Such actions, stakeholders argue, are a way to boost transatlantic economic growth and jobs.<sup>6</sup>

Cooperation is said to be particularly important given that global economic wealth and political power is shifting towards emerging economies such as China, India, and Brazil. While these developing countries are providing new sources of economic growth, they have different views on the future direction of the world economy. This could create a need for greater U.S.-EU cooperation in addressing global challenges that are important for job creation and growth for both sides.

At the November 28, 2011, EU-United States Summit meeting, President Obama, European Commission President Barroso, and European Council President Von Rompuy directed the Transatlantic Economic Council (TEC) to establish a High Level Working Group on Jobs and Growth. Led by U.S. Trade Representative Ron Kirk and EU Trade Commissioner Karel De Gucht, the working group was asked to identify policies and measures to increase U.S.-EU trade and investment to support mutually beneficial job creation, economic growth, and international competitiveness.

The working group will provide an interim report to leaders on the status of its work in June 2012. It will submit a report with findings, conclusions, and recommendations to the leaders by

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<sup>4</sup> CRS Report R41143, *Europe's Preferential Trade Agreements: Status, Content, and Implications*, by Raymond J. Ahearn.

<sup>5</sup> OECD Working Paper No. 432, *On the Benefits of Liberalizing Product Markets and Reducing Barriers to International Trade and Investment: The Case of the United States and European Union*, May 26, 2005.

<sup>6</sup> Stakeholder groups that have called for new approaches to reinvigorate transatlantic economic relations include the Atlantic Council, the Bertelsmann Foundation, the U.S. Chamber of Commerce, the Transatlantic Business Dialogue (TABD), the Confederation of European Business, and the European-American Business Council.

the end of 2012. The working group could recommend a number of possible initiatives, including enhanced regulatory cooperation, negotiation of a comprehensive free trade agreement, negotiation of a zero-tariff agreement, or negotiation of bilateral agreements liberalizing trade in services and investments.

The 112<sup>th</sup> Congress, in both its legislative and oversight roles, faces numerous issues that affect the U.S.-EU trade and economic relationship. A select group of these issues are identified and briefly described in this report. The issues are grouped into two categories:

- efforts to deepen U.S.-EU economic ties, particularly some that may be considered by the newly established U.S.-EU High Level Working Group on Jobs and Growth; and
- joint U.S.-EU efforts to strengthen the global economy.

As these issues cut across trade, economic, regulatory, and foreign policy subject matters, a number of congressional committees may have legislative or oversight responsibilities in whole or in part. On the House side, these include the Committees on Agriculture, Energy and Commerce, Financial Services, Foreign Affairs, Judiciary, Transportation and Infrastructure, and Ways and Means. On the Senate side, these include the Committees on Agriculture, Banking, Commerce, Science, and Transportation, Energy and Natural Resources, Environment and Public Works, Finance, Foreign Relations, and Judiciary.

## **Deepening Transatlantic Economic Ties**

Proposals for deepening transatlantic economic ties include the reduction of regulatory barriers, the negotiation of a zero tariff agreement, and movement towards a barrier-free investment environment. Each proposal holds the prospect of producing economic gains in terms of jobs and growth for both sides, but each also faces obstacles as freer trade creates winners and losers when it comes to jobs. A more comprehensive free trade agreement has also been proposed from time to time along with efforts to liberalize trade in selective services.

### **Reducing Regulatory Barriers**

Since the mid-1990s, both U.S. and European multinational companies have consistently identified divergent regulatory frameworks for both goods and services as the most serious barriers to transatlantic commerce. Redundant standards, testing, and certification procedures are seen by these companies as far more costly and harmful than any trade barriers imposed at the border, such as tariffs or quotas. While the purpose of many regulations is to protect consumers and the environment, divergent domestic regulations and standards add to the cost of doing business on both sides of the Atlantic and serve as non-tariff barriers to trade in many different economic activities and sectors. By reducing gaps in regulatory policies and standards, the United States and EU hope to benefit thousands of companies engaged in transatlantic trade by reducing costs, streamlining time-to-market, and improving competitiveness vis-à-vis third countries.<sup>7</sup>

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<sup>7</sup> CRS Report RL34717, *Transatlantic Regulatory Cooperation: Background and Analysis*, by Raymond J. Ahearn.

A 2009 study commissioned by the European Commission estimated that aligning and rationalizing these kinds of non-tariff barriers would bring its economy potential gains of \$158 billion in annual GDP and increase exports to the United States by 2%. EU sectors that stand to benefit include motor vehicles, chemicals, pharmaceuticals, food, and electrical goods. The United States, it was estimated, stands to gain some \$53 billion in annual GDP and a 6% increase in annual exports to the EU, with the primary beneficiaries being sectors such as electrical goods, chemicals, pharmaceuticals, financial services, and insurance.<sup>8</sup>

Many efforts have been made over the past 15 years to tackle and reduce these behind-the-border regulatory barriers, but with only limited success.<sup>9</sup> Predicated on the notion that past initiatives failed to make significant progress in enhancing regulatory progress, the Transatlantic Economic Council (TEC) was established in April 2007 at the U.S.-EU Summit. Created as a new entity by German Chancellor Angela Merkel (then European Council President), European Commission President Manuel Barroso, and President George W. Bush, the TEC was designed to provide minister-level political guidance (headed on both sides by Cabinet/Ministerial-level appointees) to foster regulatory cooperation and to reduce or eliminate regulatory burdens to trade. The TEC also covers issues such as investment, innovation, intellectual property rights, secure trade, and financial markets. The ultimate aim of the TEC is to create an integrated transatlantic market.

The Summit leaders also created an advisory group to the TEC and invited the U.S. Congress, along with the European Parliament, to accept a new, more substantive role in transatlantic regulatory cooperation by becoming part of the advisory group. In short, the TEC was designed to deal with some of the perceived shortcomings of previous transatlantic regulatory initiatives by providing high level political leadership, more involvement of legislators and other stakeholders in the regulatory process, and a greater emphasis on results than process.<sup>10</sup>

In the first three years (2007-2009) of its now almost four year history, the TEC was used primarily as a mechanism to try to resolve a number of longstanding bilateral trade disputes, most notably the EU's ban on imports of poultry that has been washed in chlorine. Efforts to harmonize regulations on a sector-by-sector basis also proved difficult due to political and bureaucratic resistance on both sides to revise existing laws and regulations. But in late 2010 the two sides agreed to focus future efforts substantially on aligning regulations and standards in emerging or new technologies, such as nanotechnology or electric cars, well before laws or regulations have been promulgated. Accordingly, at their fifth meeting, held in Washington on December 17, 2010, the TEC agreed to a work program focusing on sectors where regulatory cooperation can help avoid unintended trade barriers in the future.

Among the highlights of this TEC meeting, the two sides agreed to develop a process for implementing compatible approaches for the regulation of new and innovative sectors. In this manner, it is hoped that trade disputes due to different regulations could be avoided. The meeting also provided new impetus for regulatory cooperation in specific sectors such as electronic health records, energy-saving products, and electric vehicles as a way of reducing costs and preempting

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<sup>8</sup> Ecorys, *Non-Tariff Barriers in EU-US Trade and Investment: An Economic Analysis*, Report for the European Commission, 2009.

<sup>9</sup> For an account of these efforts, see CRS Report RL34717, *Transatlantic Regulatory Cooperation: Background and Analysis*, pp. 13-17.

<sup>10</sup> CRS Report RL34735, *Transatlantic Regulatory Cooperation: A Possible Role for Congress*, by Raymond J. Ahearn and Vincent Morelli.



unnecessary obstacles to exports. The TEC meeting also launched an Innovation Action Plan designed to strengthen joint efforts to promote innovation and the commercialization of emerging technologies.<sup>11</sup>

These work plans were touted by senior officials as more specific and time-bound than previous work plans. Whether the results will be more tangible and commercially significant remains to be seen. Part of the problem is that regulatory cooperation is difficult and technically demanding work, with wide differences between the two sides concerning approaches to regulation. Key differences bear on public preferences and tolerance for risk, attitudes towards transparency, and institutional capacities to undertake regulatory reforms.<sup>12</sup>

At its sixth and most recent meeting, held November 29, 2011, the TEC co-chairs established (at the direction of U.S. and EU leaders at the November 28, 2011, Summit) a joint High Level Working Group on Jobs and Growth. The working group will identify and assess options for strengthening the U.S.-EU trade and investment relationship, especially those that have highest potential to support jobs and growth. The TEC was also tasked by the Leaders to foster regulatory cooperation in an effort to avoid new and unintended barriers to trade and investment, especially in key emerging technologies and innovative sectors.<sup>13</sup>

## **Negotiating a Zero-Tariff Agreement**

When U.S. and EU trade officials meet these days, it is more likely that they will be discussing product standards and regulations than tariff barriers imposed at the border. One reason this is the case is that successive rounds of multilateral trade liberalization have dramatically reduced tariffs on transatlantic trade in goods, including food, to very low levels. In the United States, the simple average tariff imposed on a most-favored-nation basis on imports of manufactured goods and agricultural products is around 4% and 9%, respectively. Comparable figures for the EU are 4% on manufactures and 18% on agricultural products.<sup>14</sup>

Despite these generally low average tariff levels, there is interest in the U.S. and EU business communities to eliminate all remaining tariffs imposed on U.S.-EU trade through a bilateral negotiation. Support for the proposal is based on a combination of factors, including the agreement's ability to: (1) generate economic benefits for both sides, including reducing costs to companies that pay tariffs on trade with their foreign affiliates; (2) re-energize transatlantic economic ties; and (3) pressure recalcitrant countries in the Doha Round to undertake more concessions.<sup>15</sup>

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<sup>11</sup> International Trade Reporter, "Transatlantic Council Meeting Advances Regulatory Cooperation, Innovative Strategies," 27 ITR 1963, December 23, 2010.

<sup>12</sup> See CRS Report RL34717, *Transatlantic Regulatory Cooperation: Background and Analysis*, pp. 7-9.

<sup>13</sup> The White House, Office of the Press Secretary, November 30, 2011.

<sup>14</sup> The higher average tariffs for agriculture may reflect the strength of ongoing pressures to protect some farmers and products from international competition on both sides of the Atlantic. The data source on average tariffs is from various editions of the World Trade Organization's Trade Policy Review for both the United States and European Union.

<sup>15</sup> The Doha Round of multilateral trade negotiations, formally the Doha Development Agenda (DDA), is an ongoing attempt to lower trade barriers around the world. Commenced in November 2001 under the auspices of the World Trade Organization, the Doha Round is now the longest running multilateral trade negotiation in postwar history.

One study estimated that there would be significant trade and welfare benefits for both sides from a full elimination of tariffs on U.S.-EU merchandise trade over time.<sup>16</sup> In the aggregate, the study projects that total EU exports to the United States could increase by up to \$69 billion in value, or 18 percent, while U.S. exports to the EU could rise by up to \$53 billion, or 17 percent. In terms of increases in GDP, the EU economy could gain anywhere from \$58 billion to \$85 billion and the U.S. economy anywhere from \$59 billion to \$82 billion.<sup>17</sup> These potential gains, according to the authors, are considerable in absolute terms and higher than in most preferential free trade agreements signed by the United States or EU, or agreements currently being negotiated.<sup>18</sup>

In the past, a major objection to a transatlantic zero-tariff agreement was that it could undermine the multilateral system because it was a preferential or discriminatory trade agreement between the two biggest trade blocs in the world. Critics maintained that such an agreement would likely be inconsistent with the WTO obligation that preferential agreements cover “substantially all trade.”<sup>19</sup> This is particularly due to strong opposition on both sides to include a number of agricultural sectors.<sup>20</sup> As a result, critics traditionally argue that any preferential agreement struck by the world’s biggest economies would send a signal to the rest of the world that the United States and EU had abdicated responsibility for leadership of the multilateral system and could spell the death knell of efforts to bring the Doha Round to a close.

Supporters have countered that a zero-tariff agreement could cover “substantially all trade” in a WTO-consistent manner by exempting only a handful of sensitive agricultural products from tariff elimination on both sides and by providing long phase-out periods for tariff cuts on other sensitive agricultural items. Given the long stalemate in completing the Doha Round, supporters also view a U.S.-EU preferential agreement as creating new leverage for the United States and EU to use in an effort to influence emerging economies to make more constructive offers to conclude the Doha Round. They also point to past instances in which regional or bilateral agreements, such as NAFTA, may have served to spur multilateral trade liberalization.<sup>21</sup>

For the Obama Administration to enter into a tariff negotiation with the EU, Congress would have to extend the President’s tariff-cutting authority. To date, no such proposals have been introduced in the 112<sup>th</sup> Congress.

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<sup>16</sup> These gains combine both short-run “static gains” and longer-run “dynamic gains.” Static effects are associated with an improvement in allocative efficiency as firms accrue cash flow benefits from elimination of tariff payments and intermediate and final consumers benefit from lower prices. Dynamic gains accrue after the elimination of tariffs has worked its way through the economy by triggering a reallocation of resources (labor and capital) and changes in the returns to the factors of production.

<sup>17</sup> These gains for both exports and GDP are assumed to occur by 2015, or five years after the hypothetical cuts are enacted.

<sup>18</sup> Fredrik Erixon, and Matthias Bauer, “A Transatlantic Zero Agreement: Estimating the Gains from Transatlantic Free Trade in Goods,” European Centre for International Political Economy, ECIPE Occasional Paper, April, 2010.

<sup>19</sup> Free trade agreements can be consistent with Article XXIV of the General Agreement on Tariffs and Trade and now the WTO if they meet a three-part test relating to notification, trade coverage (“substantially all”), and level of barriers to third-country trade. However, the WTO, in practice, has not examined whether free trade agreements reported to it are consistent with Article XXIV.

<sup>20</sup> For example, in a multilateral context, proposals have been made to negotiate the elimination of tariffs for only a few selected sectors such as oilseeds and fruits and vegetables. Political sensitivities in restraining liberalization in sectors such as dairy and sugar remain strong.

<sup>21</sup> Fredrik Erixon and Gernot Pehnelt, “A New Trade Agenda for Transatlantic Economic Cooperation,” *European Centre for International Political Economy*, Working Paper No. 09/2009.

## **Negotiating a Barrier-Free Investment Agreement**

Foreign investment has overtaken trade as the major component of U.S.-EU economic relations. While the two sides together account for around 40% of world trade in goods and services, they account for over 60% of the inward stock of foreign direct investment (FDI) and 75% of the outward stock of FDI. Moreover, Europe and the United States remain the most profitable regions of the world for each other's multinational corporations, accounting for about half of total global affiliate earnings.<sup>22</sup>

These high levels of cross-investment are facilitated by two of the most open and hospitable climates for foreign investment in the world. At the same time, pressures for investment protection have surfaced from time to time and some restrictions on foreign investment persist.<sup>23</sup>

European companies seeking to invest in the United States face two possible hurdles. The first are U.S. restrictions on foreign ownership in the shipping, energy, and communications sectors. The second relates to the review process the United States has established for examining foreign acquisitions, mergers, and takeovers from a national security perspective.<sup>24</sup> While this inter-agency process, known as the Committee on Foreign Investment in the United States (CFIUS), has generally run smoothly, the EU has raised concerns about the legal and economic costs for firms to circumvent or undergo CFIUS review.<sup>25</sup>

The EU position with regard to investment restrictions is more complicated than in the United States. The EU requires national treatment for foreign investors in most sectors and, with few exceptions, EU law requires that any company established under the laws of one member state must receive national treatment in all member states, regardless of a company's ownership. While EU law does impose some restrictions on foreign investment, member states impose a range of different policies and practices on foreign investors that are far more restrictive.<sup>26</sup>

Prior to the adoption of the Lisbon Treaty in December 2009, the European Commission shared competence with member states on investment issues.<sup>27</sup> Member states negotiated their own bilateral investment treaties (BITs) and generally retained responsibility for their own investment regimes, while the EU negotiated investment provisions in EU preferential trade agreements.<sup>28</sup> Under Lisbon (Article 207), the competence for investment rests solely with the EU. However, foreign direct investment is not defined in the Treaty, leaving unclear the practical implications for EU efforts to negotiate investment agreements and set EU investment rules. If member states and the European Commission agree on a broad definition, the EU will have much greater

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<sup>22</sup> Dan Hamilton, *The Transatlantic Economy 2010: Annual Survey of Jobs, Trade, and Investment Between the United States and Europe*, The Center for Transatlantic, Johns Hopkins University, Brookings Press, 2010.

<sup>23</sup> Philip Whyte, "Narrowing the Atlantic: The Way Forward for EU-U.S. Trade and Investment," *Centre for European Reform*, April 2009.

<sup>24</sup> CRS Report RL33388, *The Committee on Foreign Investment in the United States (CFIUS)*, by James K. Jackson.

<sup>25</sup> European Commission, *U.S. Trade Barriers Annual Report*, 2008, p. 19.

<sup>26</sup> Office of the United States Trade Representative, *National Trade Estimates Report*, 2010.

<sup>27</sup> CRS Report RS21618, *The European Union's Reform Process: The Lisbon Treaty*, by Kristin Archick and Derek E. Mix.

<sup>28</sup> Member states have concluded some 1200 BITs, almost half of the BITs enforced around the world, to provide protection for fund repatriation and against unfair or uncompensated expropriation. They do not include market access or liberalization commitments. See Stephen Woolcock, *The Treaty of Lisbon and the European Union as an actor in international trade*, European Centre for International Political Economy, Working Paper No. 01/2010.

authority on this issue and may be eager to enter into a major negotiation to demonstrate its new competence over investment policy.<sup>29</sup>

Calls for a U.S.-EU investment agreement that would create a barrier-free climate for bilateral investment and serve as a model for the rest of the world are not new. In the past, some have proposed that agreement could be modeled on the current bilateral investment treaties, with a dispute resolution process that would allow foreign investors and host governments to address their differences. The accord could also establish minimal standards for corporate governance and transparency designed to ensure that the host country has reasonable confidence in the identity and management of the investing company, as well as include new issues such as e-commerce, competition policy, and limits on the use of local (sub-federal) investment incentives. Once an accord was in place, foreign investors would be able to invest in all sectors of the economy, with exceptions only for national security.<sup>30</sup>

Any attempt to harmonize processes for considering national security exceptions would likely be very difficult. While the U.S. CFIUS process has been in place for many years, there is no similar overarching framework in Europe that allows for security considerations to be balanced against commercial interests in a systematic way. Arguably, a great diversity of attitudes towards foreign investment throughout Europe could make it difficult to develop an EU-wide approach.<sup>31</sup>

## **Cooperation to Strengthen the World Economy**

For much of the post World War II era, the United States and Europe provided key leadership to the global economy. Given the heft of their combined economies, what was decided by the two powers was often adopted by the rest of the world. While the United States and the EU still today remain central to the global economy, other countries have grown in prominence. This redistribution of global economic power, in turn, arguably increases the need for the United States and EU to work together to promote their continued competitiveness, and to ensure that the rules of the global economy remain steeped in values and principles that both sides share.

Such cooperation is already taking place on a wide range of issues including access to raw materials, intellectual property protection, and changes in global and financial market governance. This section highlights mutual challenges on completing the Doha Round, influencing China to operate its economy more in accord with market principles, and reducing global imbalances.

## **Completing the Doha Round of Multilateral Trade Negotiations**

The United States and the EU have played a special role in creating the post-war WWII global trade and finance framework of market-based rules and institutions. The relative openness of the world trading system has been greatly facilitated by multilateral negotiations and agreements undertaken under the auspices of the General Agreement on Tariffs and Trade (GATT) and now its successor organization, the World Trade Organization (WTO). Yet, the WTO Doha

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<sup>29</sup> Office of the United States Trade Representative, *Trade Estimates Report*, 2010.

<sup>30</sup> The Atlantic Council of the United States, *Transatlantic Leadership for a New Global Economy*, Policy Paper, 2007.

<sup>31</sup> Nicolas Veron, "Europe Needs Consistency in Welcoming Foreign Investors," *Bruegel*, January 2011.

Development Round of multilateral trade negotiations, begun in November 2001, has entered its 11<sup>th</sup> year, making it the longest running multilateral negotiation in the postwar era. While the last multilateral trade negotiation, the Uruguay Round, took eight years to complete (1986 to 1994), many observers believe that a Doha agreement needs to be reached to boost global trade, create jobs, bolster economic confidence, and maintain the credibility of the multilateral process.<sup>32</sup>

The Doha negotiations have been characterized by persistent differences between developed and developing countries on major issues affecting agriculture, industrial tariffs and non-tariff barriers, and services. The United States and the EU, for the most part, have shared similar interests in encouraging developing countries, particularly the big emerging economies such as China, Brazil, and India, to open their markets further for services and manufactured goods, while retaining some measure of protection for their own agricultural sectors.<sup>33</sup> Developing countries have sought the reduction of U.S. and EU agricultural tariffs and subsidies, non-reciprocal market access for manufacturing sectors, and protection for their services industries. Because U.S. and EU markets are already quite open, developing countries may not believe that they have much to gain by giving up protection of their markets for goods and services. Some developing countries also may fear that additional concessions may lead to greater competition from China rather than the United States or Europe.<sup>34</sup>

Despite a strong coincidence of interests, some distance between the U.S. and EU positions developed over a July 2008 draft agreement that was proposed in Geneva. EU trade officials viewed the draft as a possible basis for an agreement, but U.S. trade officials, backed by U.S. business and farm lobbies, argued that the concessions offered by the emerging economies were too minimal to form the basis for a deal. As a result, subsequent efforts have been made by the United States to persuade China, Brazil, and India to provide more trade and investment liberalization without much active assistance from EU negotiators.<sup>35</sup>

Given shared interests in opening emerging markets further to industrial goods and services, U.S. and some EU business interests have urged negotiators on both sides to work together to more actively press these other economies for concessions. EU negotiators have remained skeptical and somewhat reluctant to move in this direction perhaps out of concern that greater ambition would require further EU concessions on agriculture.<sup>36</sup>

It remains uncertain whether closer U.S.-EU cooperation and coordination in pushing developing countries to make additional concessions would be successful. However, if a more ambitious Doha agreement is not struck by the end of 2012, many observers believe that it could result in the first outright failure of a multilateral trade round in the postwar era. What impact this might

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<sup>32</sup> Jagdish Bhagwati and Peter Sutherland, *The Doha Round: Setting A Deadline, Defining A Final Deal*, High Level Trade Experts Group Interim Report, January 2011.

<sup>33</sup> According to USTR, under the current draft agreement, China would be allowed to exempt up to 420 industrial products from tariff cuts, India would offer no new market access for 97 percent of its total tariff lines covering industrial products, and Brazil would be shielded from increasing market access on nearly half of its industrial products. Nor have any of these three countries offered to provide significant liberalization of their services sectors. See Remarks by Ambassador Miriam Sapiro at the European Policy Centre, February 10, 2011. Found at <http://ustr.gov>.

<sup>34</sup> Gary Clyde Hufbauer, Jeffrey J. Schott, and Woan Foong Wong, *Figuring Out the Doha Round*, Peterson Institute for International Economics, June 2010.

<sup>35</sup> Statement of the U.S. Chamber of Commerce before the House Ways and Means Subcommittee on Trade Hearing, "Enhancing the U.S.-EU Trade Relationship," July 27, 2010.

<sup>36</sup> *Ibid.*

have on the multilateral trading system and the WTO's credibility as a negotiating forum and as an arbitrator of trade disputes remains to be seen. But such an outcome could leave the United States and the EU with the challenge of developing other approaches for liberalizing trade on a multilateral basis and for strengthening the WTO as an institution.

## Dealing with China

China presents major trade challenges and opportunities for both the United States and the EU. Three decades ago, China's trade with the United States and the EU was negligible. Today China is the EU's second largest trade partner, after the United States, and its biggest source of imports. For the United States, China is currently the second largest trading partner (after the EU), its third largest export market, and its biggest supplier of imports.

China's emergence as the world's second largest economy and the world's biggest merchandise exporter has been facilitated greatly by the openness of markets in the United States and Europe. As shown in **Table 3**, U.S. and EU trade deficits with China in recent years have been huge in absolute terms and they have also constituted a large share of each sides' merchandise deficits with the world.<sup>37</sup> In 2010, the trade deficit with China constituted 43% of the overall U.S. trade deficit. For the EU, its trade deficit with China is more than twice as large as its trade deficit with the world.<sup>38</sup> At the same time, China's huge population and booming economy have made it a large, and one of the fastest growing markets for U.S. and EU exports and investment.

**Table 3. U.S. and EU-27 Trade Deficits with China, 2008-2010**

(billions of dollars)

Country	2008	2009	2010
U.S deficit with China	-268	-226	-273
U.S. global trade deficit	-816	-503	-634
EU deficit with China	-247	-184	-239
EU global trade deficit	-286	-78	-108

**Source:** Global Trade Atlas.

**Notes:** Trade deficits are for goods or merchandise only.

China's trade surpluses and use of interventionist and trade-distorting economic policies has contributed to growing trade friction with the United States and EU over a number of issues, including China's refusal to allow its currency to appreciate to market levels, its relatively poor record on enforcing intellectual property rights, and its extensive use of industrial policies and discriminatory government procurement policies to subsidize and protect domestic Chinese firms

<sup>37</sup> The trade deficit with China has become a political issue in both the United States and the European Union. The underlying causes of these deficits are differences in savings and investment, and the shifting of production from many East Asian countries to China.

<sup>38</sup> This is made possible by the fact that the EU is running trade surpluses with most of its trading partners.

at the expense of foreign companies. These interventionist policies, according to both the United States and European Chambers of Commerce, have become more discriminatory towards foreign companies over the past several years, making it more difficult to export to China and to do business in China on a non-discriminatory basis.<sup>39</sup>

U.S. and EU trade officials have utilized two main approaches for addressing problems posed by Chinese policies and barriers that skew the playing field for trade and investment. The first has been to seek Chinese concessions during high-level summitry via the U.S.-China Strategic and Economic Dialogue (S&ED) and the Joint Commission on Commerce and Trade (JCCT) and, in the case of the EU, the EU-China High-Level Economic and Trade Dialogue. The second has been to bring disputes to the World Trade Organization, which China joined in 2001, when it is deemed that China does not comply with its WTO obligations.<sup>40</sup>

Given the potential clout that China's two most important trading partners possess and the fact that the Chinese government does appear to respect economic strength, greater U.S.-EU cooperation arguably could increase the chances for successful outcomes through both dialogue and WTO litigation. Enhanced U.S.-EU consultation and agreement on common policy approaches to issues discussed in bilateral dialogues arguably could facilitate pragmatic solutions and more favorable results if China's leaders understood that there was a united front on issues of common U.S. and EU concerns. In the past, U.S. trade officials have often felt that their European counterparts have been less vocal in expressing concern and dissatisfaction with Chinese trade practices because they thought the United States would do the "heavy lifting" (i.e., open the market) and they would then benefit from China's concessions. Understandably, given the very different experiences member states have in trading with China, the formulation of an EU-wide position is often difficult. From China's perspective, a fragmented, uncoordinated, and divided U.S.-EU approach may be preferable because it allows its policymakers to play one side off against the other, as it arguably did over the issue of currency manipulation at the 2010 G-20 meeting in Seoul.

In the case of WTO litigation, it seems that both the United States and the EU are increasingly willing to pursue WTO cases against China when it appears they are winnable. Cases where the United States and the EU serve as co-complainants arguably can enhance the profile of the case, but also ensure that China remains engaged and committed to the WTO dispute resolution process. While China initially settled many WTO cases filed against it before a panel was formed, since 2006 it has exhibited a new willingness to accept the decisions of WTO panels, thus encouraging a continuation of this approach when there appear to be clear violations of China's WTO commitments. In the process, China arguably could become increasingly vested in the maintenance of WTO norms and rules because it wants to be viewed as playing by the rules.<sup>41</sup>

Closer U.S.-EU cooperation in providing China with similar messages via high-level summitry or in filing WTO complaints, however, may not address numerous other trade and industrial policies that disadvantage U.S. and European companies because they are too complex or fall outside the purview of WTO obligations, such as China's currency policy. In these cases, U.S. and European

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<sup>39</sup> CRS Report RL33536, *China-U.S. Trade Issues*, by Wayne M. Morrison.

<sup>40</sup> Charles W. Freeman III, "China's Trade and Industrial Policies," Testimony before the House Ways and Means Committee Hearing on *China's Trade Practices*, June 16, 2010.

<sup>41</sup> Marcia Don Harpaz, "Sense and Sensibilities of China and WTO Dispute Settlement," *Journal of World Trade Law*, December 2010.

officials may still be able to cooperate on understanding and encouraging reformers in China to more actively support policies that will make China a more responsible stakeholder in the global trading system.<sup>42</sup>

## Reducing Global Imbalances

One of the underlying causes of the 2008 global recession was the presence of highly skewed trade imbalances driven by distorted global consumption and savings patterns. High savings countries like China and Germany produced more than they consumed and had to rely on export-led growth to keep their economies growing. As shown in **Table 4**, these two countries, plus Japan and some of the oil-exporting countries, experienced large current account surpluses in both the amounts and relative to the size of their economies. These surpluses, in turn, were recycled back to the United States, a low savings and large current account deficit country. The recycled funds, in turn, allowed the United States to finance a high consumption level, particularly in housing, that proved unsustainable.

**Table 4. Current Account Positions of Selective Countries, 2008-2010**

(in billions of dollars and percent of GDP)

Country	2008	2009	2010
China (\$)	436	297	270
China (% of GDP)	9.6	6.0	4.7
Germany (\$)	246	163	200
Germany (% of GDP)	6.7	4.9	6.1
Japan (\$)	157	142	166
Japan (% of GDP)	3.2	2.8	3.1
United States (\$)	-669	-378	-466
United States (% of GDP)	-4.7	-2.7	-3.2

**Source:** International Monetary Fund, World Economic Outlook Database, October 2010.

**Notes:** Data for 2010 are estimates.

Policies that correct the imbalances and provide for more balanced growth in the next decade are considered by many economists to be important for both global economic recovery and an avoidance of an outbreak of protectionism. According to this view, for large current account deficit countries like the United States, where domestic spending exceeds production, spending (both private and government) must decline and savings rise if the imbalances are to be significantly reduced. Because the U.S. adjustment involves going from the world's consumer and borrower of last resort to depending much more on export-led growth, large current account surplus countries like Germany and China will have to sustain their growth more by stimulating domestic demand and boosting imports and less by exports. This means that German and Chinese

<sup>42</sup> Charles W. Freeman III, "China's Trade and Industrial Policies," op. cit.



domestic spending will need to rise either through increases in consumption, investment, or government spending, or a combination of all three.<sup>43</sup>

At a November 2010 Summit in Seoul, leaders of the Group of 20 major economies (G-20) agreed to curb “persistently large imbalances” in trade that are deemed to pose serious risks to global economic growth and an open world trading system. While the group’s communiqué reflected an emerging consensus that longstanding economic patterns—in particular the United States consuming too much and big trade surplus countries like China and Germany consuming too little—were no longer sustainable, agreement to monitor and address such imbalances in future meetings fell short of initial U.S. proposals to place quantitative limits on deficits and surpluses.<sup>44</sup>

China and Germany led the resistance to U.S. efforts to place limits on surplus countries. In the weeks prior to the summit, both countries countered U.S. proposals by criticizing the loosening of monetary policy (quantitative easing) by the Federal Reserve, arguably diverting U.S. pressure on them to reduce their surpluses. In the process, the G-20 Summit in Seoul revealed a new focus of conflict over the management of the global economy. While U.S.-China differences are the most prominent and longstanding, having centered on China’s trade surpluses and its intervention in the foreign exchange market to keep the value of its currency from appreciating, the U.S.-German policy cleavage is newer and centered around macroeconomic policy disagreements. Reflecting perhaps a broader shift in European thinking, driven by German insistence on fiscal austerity, the new cleavage has the potential to challenge some of the underlying assumptions of the transatlantic economy and alter the international debate on global imbalances by positioning Germany and China against the United States on this particular issue.<sup>45</sup>

German policymakers reject the notion that the country’s export surpluses need to be trimmed. German Finance Minister Wolfgang Schäuble, for example, has argued that other countries, including the United States, should impose fiscal austerity and tighter monetary policy to right the global economy.<sup>46</sup> Due in part to the spillover effects of the Eurozone crisis (sovereign debt problems of Greece, Ireland, Portugal, and Spain), Germany has also urged its Eurozone partners (16 other members of the EU that share a common currency, the euro) to undertake austere economic policies.

Many German policymakers tend to believe that the Eurozone should be turned into a larger version of their nation—a zone where fiscal responsibility reigns and every country lives within its means. A Eurozone built on Germany’s image, the argument goes, would be more prudent, responsible, and competitive. This view may be supported by many countries in northern Europe such as Austria and the Netherlands. A case can be made, in the midst of the Greek and Irish sovereign debt crises, that Eurozone members need to restore faith in the way they manage their

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<sup>43</sup> An OECD analysis holds that Germany could best increase its consumption and living standards by opening its services sector to more domestic and international competition.

<sup>44</sup> Sewell Chan, “Obama Ends G-20 Summit With Criticism of China,” *New York Times*, November 12, 2010.

<sup>45</sup> C. Fred Bergsten, “Worrisome Outcome from the G-20 Summit,” edited transcript recorded November 12, 2010, Peterson Institute for International Economics Interviews on Current Topics.

<sup>46</sup> Cast differently, Germany is convinced that its current account surplus is the result of prudent economic policy and hard work and that it is not to blame for troubling global imbalances. But as a simple matter of accounting, a German or Chinese trade surplus must be offset by another country’s trade deficit. In a recent interview, IMF Managing Director Dominique Strauss-Kahn observed that “you can’t defend your own surplus and at the same time criticize others’ deficits.”

public finances. However, if the current account surplus countries such as Germany and the Netherlands also pursue austere fiscal policies, the Eurozone may contribute little or nothing to global demand, thereby putting more pressure on the international trading system at a time when most countries around the world are trying to grow faster by exporting.<sup>47</sup>

One possible result of austere fiscal policies across the Eurozone, combined with the continuation of heavy German reliance on export-led growth, could be a weaker euro and slower growth across Europe. This, in turn, could lead to a big increase in Europe's trade and current account surplus with the rest of the world by several hundreds of billions of dollars. Coming on top of continuing Chinese and other Asian trading surpluses, European surpluses could help push U.S. trade deficits to record levels, risking an upsurge of protectionism.<sup>48</sup>

## **Outlook**

U.S.-EU trade and economic relations are healthy, complex, and mutually advantageous. Joint concerns about slow growth, job creation, and increased competition, however, have prompted a number of proposals for deepening transatlantic economic ties. Over the course of this year, a High Level Working Group on Jobs and Growth will assess a wide range of proposals to deepen economic ties, reduce remaining barriers to trade and investment, and to enhance regulatory cooperation. Whether any new, major policy initiative will be advanced by the working group to accelerate the integration of the two economies or to foster greater government-to-government cooperation in dealing with mutual global economic challenges remains to be seen.

Much could depend on the views and measures supported by business, nongovernmental organizations, and other stakeholders on both sides of the Atlantic. Any bold undertaking may also require sustained high level political support. As U.S.-EU trade and economic interactions continue to play an important role in affecting growth and the creation of new jobs on both sides of the Atlantic, the 112<sup>th</sup> Congress can be expected to monitor ongoing efforts to deepen transatlantic ties.

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<sup>47</sup> Philip Whyte, "Why Germany Is Not a Model for the Eurozone," *Centre for European Reform*, October 2010.

<sup>48</sup> C. Fred Bergsten, "A Return to Global Imbalances," edited transcript recorded June 15, 2010, Interviews on Current Topics, Peterson Institute for International Economics.

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