

## WILL THE LARGEST AGREEMENT IN THE WORLD BE ACHIEVED?

*Swedish lawyer Jan E. Frydman analyzes the background for the on-going negotiations between the EU and the United States to create a transatlantic partnership on trade and investment (Trans-Atlantic Trade and Investment Partnership, or "T-TIP"), focusing on the challenge of regulatory convergence.*

The purpose of the T-TIP is to reduce or eliminate barriers to trade and investment between the two economies. The idea is by no means new. Already back in 1995, both sides started an effort towards a kind of free trade agreement between the EU and the United States (the New Transatlantic Marketplace, or "NTM"). The reason was as obvious then as it is now: more trade leads to more growth and more jobs, which of course both politicians and the business community on both sides of the Atlantic wished for. A dialogue between political leaders and the business community – the Trans-Atlantic Business Dialogue ("TABD") - also started to identify the most important barriers to trade and investment and present annual recommendations to the European Commission and the United States Government. Removing unnecessary barriers sounded obvious, but unfortunately it was – and is - not so simple.

NTM proved difficult for various reasons, including disagreements over how to handle certain sectors, particularly the agricultural sector and that of cultural goods including audiovisual production. To this can be added a general political reluctance, as well as a more general fear that an agreement between the largest trading partners in the world would jeopardize the multilateral trade negotiations that, since long, had been going on in the World Trade Organization, WTO, in Geneva. In the end, the negotiations ended in 1998.

Since then, numerous attempts have been made to try to increase transatlantic trade by eliminating trade barriers short of actual free trade negotiations. According to EU law, it is the European Union, represented by the European Commission, that is responsible for trade matters, and therefore the Commission represents the Union, including Sweden, in negotiations with countries that are not members of the EU in these matters.

In 1999, I became responsible for transatlantic relations in the European Commission's Directorate General for Enterprise and Industry, and in that capacity, and in later positions there as responsible for the coordination of international negotiations related to the regulatory aspects of trade in goods, I had the opportunity to work with these efforts. These have been characterized by a complex interplay between economics, law, and, not least, domestic and foreign policy concerns.

The basis for the EU's trade policy is that it should primarily be conducted within the framework of the WTO multilateral negotiations. The idea is that it is better and more effective to negotiate with 159 countries (as many are members of the WTO) rather than to do it bilaterally with some. That way one can also avoid a "spaghetti bowl" of free trade agreements with various content that will be

difficult to apply together. For a long time, multilateral efforts were successful. Trade barriers, especially tariffs, have been reduced considerably over the years in various so-called rounds.

The current round of negotiations, however, the Doha Development Round, has been going on for more than a decade, and has stalled for some years now. There are several reasons for this, including difficulties to reconcile the often conflicting interests that exist between developed and developing countries. Because of this, in particular the EU and the USA have chosen to follow a "plan B", which is to instead try to negotiate bilaterally with major trading nations to still be able to move towards greater trade liberalisation where possible.

Why is this important for the EU? Well, one reason is that, soon, almost 90 percent of global demand for goods and services will come from markets outside the EU. It is therefore important to open up these markets as far as possible to enable European companies to access them without too many barriers. With FTAs, this can hopefully be achieved with the most important trading nations. Within the EU, we developed a strategy that we called "Global Europe", which was followed by the so-called "2020-strategy", and these have so far resulted in free trade agreements between the EU and South Korea and, just recently, with Canada, while negotiations are underway with India, ASEAN countries, Japan, Mercosur, and others. And now also with the United States.

Why is America so important? Would it not be better to focus on China that is so much bigger? Yes, you might be inclined to draw that conclusion if you only read newspaper headlines. But the truth is that the EU and the US without any comparison are each other's largest trading partners. Every day more than 2 billion dollars worth of goods and services cross the Atlantic, an amount equal to approximately 40 percent of world trade, and nearly half of all the world's total production. But the transatlantic relationship is even more important if we consider "investment", i.e. the ownership of companies/subsidiaries, and sales made through them. If you do that, you will discover that the EU and the US are the most integrated economies in the world. It is said that they are "interdependent". Nearly 60 percent of all investments made by European companies outside the EU have been made in the United States, while about 60 percent of all investments made by American companies outside the United States since 2000 have been made in the EU. In fact, only 1.2 per cent (!) of America's foreign investment during the same period that have been made in China; less than what was invested in Belgium alone. America's investment only in the Netherlands is four times larger than what is invested in all the BRIC countries (Brazil, Russia, India and China) together! Similar proportions apply to how much money the companies earn. American businesses earned more in Europe than they did in all of Asia and Latin America together. The same applies to European companies in the United States. So, even if growth in China is high, there is a difference between growth and absolute numbers!

Then, why is it that so far we don't have a free trade agreement with the United States? One might perhaps say that ever since the first attempt with the NTM, we have on both sides been "beating around the bush" and, rather than negotiate a free trade agreement, done a lot of ground work towards removing barriers. We have devoted time to investigate how our systems work, what the differences are, and tried to address some of those differences in some specific sectors. But while we

have learned much about each other's systems, it has been much more difficult to remove the barriers.

Trade barriers can appear in different forms. One, of course, is in the form of customs duties. Between the EU and the US these are on average about 4 percent. This may not sound like much, but applied on such a huge trading volume, it is not an insignificant burden, not least for "inter-company trade", i.e. trade between companies within the same group. There are also substantially higher duties in some industrial sectors, such as for chemical products.

Traditional trade agreements address different areas that can facilitate trade. Simplified, one can say that each such area is covered by a chapter of the agreement.

The most typical of these chapters deal with access to each other's markets for goods, services, investment and the right to participate in public procurement. In terms of goods, an important component is indeed "tariff barriers", i.e. customs duties. Negotiations aim for agreement to reduce tariffs over a certain period on some or all products to certain percentages, or even to remove them completely. It is sometimes not easy to agree on this, but technically it is not too complicated.

It is harder to deal with what is called "non-tariff barriers". These are just as important as the tariffs, in many cases even more important. There are many such barriers, and all must be handled differently. Between the EU and the US, the largest - and also the most difficult - stumbling block can be found in this category, and concern differences in regulations for the products we want to sell to each other. For example, when EU companies that manufacture cars, boats, toasters, drugs or toys that satisfy EU regulations also want to sell them to the United States, they must make sure that they also meet American regulations, standards, and, not least, controls how they comply with such rules, known as "conformity assessment procedures". Similarly, American products sold into the EU must comply with corresponding EU requirements, even though they satisfy US regulations and thus may be sold in the United States. Indeed, often these requirements are not the same, and a company that wants to sell to both markets incurs a higher cost and longer time to market, since they may have to make two models of each product, carry out double testing, and more. It also makes it harder, less flexible and more costly to manage "the global supply chain." For example, the cost of producing a car would be about 6 percent lower if only one model needed to be produced. Corresponding figures apply to many other areas, and they are thus often higher than the cost of tariffs.

Large companies may be able to handle this, even if it costs time and money, but for many small and medium sized enterprises, these regulatory differences may be prohibitively expensive, meaning that they can only sell to one market. They may thus potentially miss out on sales and profit opportunities. That means there will be fewer jobs. And consumers will have fewer products to choose from, for example, in the pharmaceutical field. Overall, it is in this area where both the EU and the US might have the most to gain from an FTA. If, for example, we will manage to remove half of all such barriers, that would be equal to 3 times the value that the entire Doha Development Round would bring if it were completed on the current bid levels.

Is it not the same problem with all free trade agreements? To some extent it is, but since the regulatory differences represent the most important trade barriers between the EU and the US, the ambition is for T-TIP to focus more on those than what has been done in previous FTAs. One could also, a bit simplified, say that most of the countries with which either the EU or the US concluded free trade agreements either regulate their products according to an international system that the EU or the US follows, or agree to follow the EU or the US' rules. But now, when it is the EU and the US that negotiate with each other, it is the first time that two similarly sized and, in this respect, equal partners do so. So who should change their rules and, if so, how? Or should they recognize each other's regulations as equivalent? This is, in a nutshell, the key question; a question that I and my former colleagues at the European Commission and my "counterparts" within the American government have worked on for a long time.

As a lawyer, I am reminded of the various attempts that have been made throughout history since at least antique times to harmonize legislation to facilitate trade; not least in Europe with Roman law. More recently, extensive harmonization or mutual recognition efforts took – and are taking – place in the EU in order to create the EU single market. Also within the US, there is a "single market", although it functions differently from that of the EU.

History is said to repeat itself, and if the ambition is to now create a transatlantic market, it may not be entirely wrong to seek inspiration in our predecessors' work. The difficulty here is obvious. While the Roman emperors of their time, and the EU and US institutions of our time, have been able to provide for harmonization or mutual recognition internally on the basis of their respective powers and treaties, we are talking here about doing this between the EU and the US; two different and independent sovereign jurisdictions, with different political and legal systems, without common regulatory institutions, joint executive authorities and, not least, a common court.

In the absence of such "means" we have so far over the years had to resort to new and innovative legal and political solutions to gradually support regulatory cooperation in the hopes that this would lead to harmonization or mutual recognition where possible between regulations in the EU and the US. Many initiatives have been taken over the years, including an agreement on the mutual recognition of certain conformity acceptance certificates for goods, signed in 1998, the Guidelines on Regulatory Cooperation and Transparency, which we completed in 2002, with associated and annually adopted Roadmaps for implementation both horizontally and in many industrial sectors, the High Level Forum for Regulatory Cooperation on legislative and regulatory issues that was created in 2005 to coordinate this work on senior level, and a Framework for Economic Integration, concluded in 2007 and which created the Transatlantic Economic Council (TEC) to also coordinate this on political level. The extensive work that has been undertaken has enabled the EU and US sides to develop a structure for cooperation, and gain invaluable knowledge about each other's legal systems that now hopefully can be used in the continued work towards a free trade agreement.

Will it succeed this time? It's not certain. While it should be possible to agree on the traditional "free trade chapters", the differences in regulations will take longer to tackle and may need its own

process. After 15 years of work in this area, I have been able to conclude that there are many areas where the EU and the US have arrived at different solutions. The differences arose "naturally" since each country normally regulate its products with respect only to its own taste, preferences and traditions, how much risk it is prepared to tolerate, and how it chooses to manage these risks. In the EU, for example, there is fear of American chicken treated with chlorine to prevent salmonella bacteria, while in the United States French cheeses are considered dangerous if they are not pasteurized. And who has the best system for regulating chemicals?

It is also clear that - contrary to what many seem to believe - it is not possible to "negotiate away" differences in regulations since, in order to implement regulatory changes, legislation of some sort is needed on both sides: in the United States, this often requires mandates from Congress under which decisions are taken by regulatory agencies in special administrative procedures; in the EU, according to the legislative procedures that apply to each area. This means that whatever trade negotiators on both sides may have agreed must then follow the legislative or administrative procedures required to implement the results. And it is not certain that legislators or regulators, which can be very independent, agree! In legislative or regulatory work, emotional and political considerations also play a role. And what if one side after it's been agreed wants to change their rules? The business community on both sides of the Atlantic will also need to agree on product standards. Of course it is also important for civil society on both sides of the Atlantic to be involved in and support the process.

To avoid disappointment, both sides also need to be clear about the level of ambition with the negotiations. For example, in the regulatory area, before the T-TIP negotiations began, the cooperation between the EU and the US only focused on a few individual regulatory differences in certain industrial sectors, and not on all regulations affecting the sector, despite the fact that most products sold are covered by several regulations. A car, for example, is regulated by a large number of rules and standards relevant for all of the components that make up the car. The question therefore becomes whether the ambition in the T-TIP is to just, for example, negotiate the rules for door locks and seat belts, or for the entire car. Or if we will only coordinate the process for how to approve medical drugs, but not the result. So far we have done the former, while the expectations of industry was the latter, i.e. for the product to be "approved once, accepted everywhere" and thus that it should be possible to sell it in both markets without requiring changes and new conformity assessment procedures, a kind of transatlantic market. Therefore, it is now important that the EU and the US carefully defines the common ambition on what should be achieved for each industrial sector covered by T-TIP. The same also applies to services.

At the same time, many believe that "this time it's different". There is now a clear political commitment on both sides, and President Obama, and leaders of the EU have expressed their support for an agreement. The political ambition has increased for at least three reasons. First, the continuing economic crisis has created a strong interest to find a way to increase growth that does not cost much to the Treasury. Second, the geopolitical dimension plays a role: with the increasing importance and growing ambition of the BRIC countries (Brazil, Russia, India and China) both the EU and the US considers it useful to cooperate to ensure that the regulations and standards used in global trade will reflect the values and systems that the EU and US can jointly agree on, and thus not be determined by others who do not share these values and systems. The idea is not to exclude

anyone; those who want to should be welcome to join the agreement. Third, it is believed that an agreement between the EU and the US will perhaps boost multilateral negotiations in the WTO.

The transatlantic free trade negotiations are now fully underway. Given the significant trade between Sweden and the United States, there should be an interest to follow them closely.

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