EUROPEAN PARLIAMENT

IMPA
Impact Assessment

Initial appraisal of a European Commission Impact Assessment

European Commission proposal to authorise the opening of negotiations on a Transatlantic Trade and Investment Partnership between the European Union and United States of America

Impact Assessment (SWD (2013) 68 final, SWD (2013) 69 final (summary)) for a Recommendation for a Council Decision authorising the opening of negotiations on a comprehensive trade and investment agreement, called the Transatlantic Trade and Investment Partnership, between the European Union and the United States of America

- **Background**

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's Impact Assessment (IA) accompanying the above proposal to the Council, submitted on 12 March 2013.

- **Context**

The European Union and the Unites States together account for about half of the world GDP (47%) and one third of global trade flows. They are each other's main trading partners and enjoy the largest bilateral trade relationship in the world.

On 13 February 2013, the EU and the US leaders decided to take their economic relationship to a higher level by agreeing to launch negotiations for a comprehensive trade and investment partnership, which will aim to go beyond the classic approach of removing tariffs and opening markets on investment, services and public procurement. According to the Commission, the successful conclusion of such an agreement, which would be the biggest bilateral trade and investment deal ever negotiated, could add 0.5% to the EU's annual economic output.

This initiative follows the publication of the final report of the High Level Working Group on Jobs and Growth (HLWG), which was established by the EU-US Summit in November 2011 and was tasked with identifying policies and measures to increase trade and investment to support mutually beneficial job creation, economic growth and competitiveness. The report concluded that a comprehensive agreement which addresses a broad range of bilateral trade and investment issues, including regulatory ones, and contributes to the development of global rules, would provide the most significant mutual benefits, and recommended the launch of comprehensive trade and investment negotiations in this direction.

In its October 2012 Resolution on trade and economic relations with the United States, the European Parliament called for the launch of negotiations of a comprehensive EU-US trade agreement[1].

In February 2013, the European Council called upon the Commission and the Council to follow up on the recommendations of the HLWG without delay during the current Presidency of the Council and on 12 March 2013, the Commission sent to the Council a draft negotiating mandate for approval.

• Problem definition

The IA clearly identifies the issue at stake, which is that bilateral trade between the EU and the US is not fulfilling its full potential, because of the continued existence of various barriers to trade and investment which limit the emergence of a truly integrated transatlantic marketplace. The consequences of untapped trade and investment potential are a lower level of economic welfare on both sides of the Atlantic, a mutual loss of global competitiveness, reduced choice and higher prices for consumers, foregone employment opportunities and lower wages for both lower-skilled and higher skilled workers in the EU and US (IA, p. 12-15).

The IA indicates that the drivers behind the trade barriers between the EU and the US are two-fold:

- those that might be addressed by trade policy and/or regulatory cooperation and which comprise barriers relating to tariffs, regulatory measures (which affect both trade in goods and services, including public procurement) and related investment; and
- those that are less likely to be affected by trade policy, such as for example, geographical distance and consumer attitudes and preferences which contribute to determining the potential and limits for transatlantic trade.

The Commission indicates that the IA only focuses on the first type of factor (IA, p. 17).

The Commission provides an overview of the barriers relating to tariffs and regulatory measures, explaining that, as the public consultation it conducted confirms, the greatest impediment to increased trade and investment flows is not so much tariffs (which are comparatively low at 5.2% in the EU and 3.5 % in the US, with tariff peaks in sectors of economic interest to the other partners, such as agriculture and some industrial products), but regulatory differences for goods and services, which tend to increase the cost of compliance and therefore of doing business, in particular for SMEs.

The Commission considers the most significant and costly barriers to be the following, providing a brief explanation for each, including examples of the sectors most affected:

- technical regulations, standardisation, conformity assessment procedures;
- difficulties with (existing) mutual recognition agreements as to their actual effectiveness and implementation;
- sanitary and phytosanitary measures;
- insufficient or ineffective upstream cooperation on draft legislation/regulation;
- regulatory issues related to trade in services (IA, p. 18).

[1] EP Resolution of 15 October 2012 on trade and economic relations with the United States (2012/2149 (INI)) A7-0321/2012

Limited access to the US government procurement market is also identified as a specific problem, with only 32% of this market open to EU businesses, under the commitments recently agreed by the US in the framework of the WTO Government Procurement Agreement (GPA).

While the IA describes what the critical issues are, it does not fully clarify the question of in which sectors the objective of barrier reduction will be more or most difficult to attain, and why, despite being requested to do so by the Commission's Impact Assessment Board. It also does not seem to classify the trade sectors by order of importance, thus making it difficult to understand which sectors are of greater economic importance to both parties.

In addition, regarding upstream cooperation, the Commission does not seem to have followed the IA Board's recommendation 'to explain and substantiate with credible evidence what the concrete problem is, notably what the main gaps are (clearly differentiating between sector specific and more horizontal issues) and what needs to be done' (IAB's opinion of 20 November 2012).
Furthermore, the IA does not seem to explain how investment flows are hindered by the identified problems, nor does it provide practical examples of difficulties encountered by companies.

• Objectives of the legislative proposal

The overall objective of EU policy as regards economic and trade relations is to 'contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment, and the lowering of customs and other barriers' (Article 206 TFEU).

The *general* objectives of European trade policy are therefore as follows:

- 'Promoting smart, sustainable, and inclusive growth through the expansion of trade;
- The creation of job and labour opportunities and welfare gains including lower consumer prices and other consumer benefits;
- Improving Europe's competitiveness in world markets' (IA, p. 22).

The **specific** objectives regarding EU-US economic and trade relations translate into the following three pillars:

- 'Increasing the volume of bilateral trade in goods and investment in goods sectors by reducing barriers,
- Increasing the volume of bilateral trade in services and investment in services sectors by reducing barriers,
- Achieving reciprocal market access to the government procurement markets of both parties'. (IA, p. 23)

The following **operational** objectives flow from the above aims and indicate the specific areas in which potential negotiations are likely to be concentrated:

a) as regards **trade in goods**, the aim is to eliminate all tariffs, with options for the treatment of the most sensitive products. The partnership should also aim at eliminating or reducing the cost of regulatory obstacles to trade by reducing divergences where possible. Strengthened institutional mechanisms should also be set up to enhance upstream regulatory cooperation.

b) with regard to **trade in services and related investment**, the objective is to 'bind the existing level of autonomous liberalisation and to "future-proof" such liberalisation by subjecting it to a ratchet which would capture any future new liberalisation'. Furthermore, the aim is to 'achieve genuine new market access through an effective opening of key services sectors, such as transport' and 'to address regulatory barriers through closer regulatory cooperation and by establishing common regulatory disciplines' (Executive Summary, p. 3)

c) in respect of **public procurement**, the aim is 'to improve EU firms' access to public procurement opportunities in the US, inter alia by: 1. increasing the coverage of federal procurement; 2. broadening the coverage of the US sub-federal level both by increasing the number of states as well as the coverage of those currently offered by the GPA and removing the "Buy America(n)" provisions and achieving treatment equivalent to local suppliers; 3. persuading the US to progressively eliminate trade barriers to cross-border procurement (buy American provisions, sectoral derogations, in particular on mass-transit and with respect to SMEs)' (Executive Summary, p. 3).

The IA includes an analysis of the consistency of the EU's operational objectives with other EU policies, including the Europe 2020 Communication, the Communication on Trade, Growth and World Affairs, and the Communication "Small Business, Big World - a new partnership to help SMEs seize global opportunities".

- ## Range of the options considered

The IA considered the three following options:

A. The **baseline scenario,** which is the 'no policy change' option, envisaging modest progress focused on regulatory issues for goods under the Transatlantic Economic Council (TEC), the High Level Regulatory Cooperation Forum (HLRCF) and on-going sectoral dialogues.

The Commission indicates that the baseline scenario covers the period up to 2027, with projections of the world economy up to that year. The baseline includes all current EU and US signed or initiated bilateral agreements, in particular those with South Korea, and the EU agreements that are currently being finalised (EU-Canada, EU-Singapore) under stylised assumptions. 'The baseline is based on developments in the bilateral economic relationship that are likely to be generated by the evolution and current trend of the EU and the US economies as well as by the global economic situation' (IA, p. 26). (It should be noted that the baseline excludes the conclusion of the current multilateral trade negotiations in the WTO, because of their uncertain character. The base year of the data used in the simulations is 2007, so before the economic crisis. (IA, p. 7)

B. **'Tariff-only', 'services-only' or 'procurement-only' agreements**:

<u>Policy option B.1: A tariff-only agreement</u> assumes a conservative 98% elimination of all tariff lines, 'because in the absence of possible trade-offs in the negotiations between tariffs, nontariff barriers, services and government procurement, the expected abolition of tariffs is unlikely to cover all tariff lines', falling short of the goal of full duty elimination. The Commission notes that even 98% duty elimination may be difficult to achieve in the absence of comprehensive negotiations (IA, p. 26)

<u>Policy option B.2: A services-only agreement</u>: the IA explains that given the on-going preparations for a plurilateral services initiative in the WTO, in which both the EU and the US are involved, it is politically unlikely that both sides would agree to a separate bilateral services-

only track in parallel to these negotiations. The economic simulation nevertheless assumes a scenario of removing 10% of all existing barriers to trade in services in the case of a bilateral services-only agreement.

Policy option B.3: A government procurement-only agreement: an estimated 25% reduction of barriers is used under this scenario.

According to the IA, 'the tariff-only option has been advocated particularly by those stakeholders that are still concerned by tariffs, for example the agricultural industry and the manufacturing industry. A services-only option has been proposed by a limited number of services industries and the procurement-only option is evoked/in line with the Memorandum of Understanding of 1995 between the EU and the US to further look into their respective commitments in the context of the WTO Government Procurement Agreement (GPA)' (IA, p. 26)

C. **A 'comprehensive' option that involves the negotiation of a comprehensive EU-US trade and investment agreement,** covering tariffs, and regulatory barriers for goods, services, investment and government procurement simultaneously. Under this option, two scenarios are explored proposing different degrees of trade liberalization:

- a 'conservative' scenario - (policy option C1) which is in line with the individual agreements discussed above; and

- an 'ambitious' scenario - (policy option C2) (involving 100% tariff elimination, 25% in trade cost reductions of regulatory barriers and 50% of barrier elimination for public procurement) which would differ from the current EU and US standard approaches to FTAs and include three interlinked components: 'a) ambitious market access on tariffs, services, investment and procurement; b) an ambitious approach to regulatory issues, including disciplines as regards technical barriers to trade, sanitary and phytosanitary measures, upstream regulatory cooperation and enhanced sectorial regulatory compatibility beyond the EU and US standard approaches; and c) rules on a number of areas of common concern, such as trade facilitation/customs, trade-related aspects of competition policy, trade-related aspects of labour and the environment and intellectual property rights (including geographical indications)' (IA, p. 28).

The Commission indicates that its public consultations showed that most stakeholders supported a 'comprehensive, ambitious and realistic agreement that would be negotiated under a single package' (Annex 5a, p. 2)

The description of the options seems already to contain elements of their assessment, the Commission clearly appearing to privilege option C. The content of the various options is not described in detail and the link of the options with the problems they are supposed to address is rather unclear. For example, as the IA Board highlighted in its opinion 'it is not clear ... how the proposed measures will improve up-stream coordination or would solve the problems posed by the existence of different US standardisation bodies or regulatory entities at State level'.

Furthermore, the Commission does not appear to indicate how the barrier reduction targets have been set or how feasible they are, for example by referring to the results of existing free trade agreements, such as that with South Korea (which is considered as the 'standard template') (IA, p. 28).

Furthermore, while the Commission recognises that 'tariff only, services only and procurement only agreements could be partially or comprehensively combined' it does not explicitly analyse any such partial combination of options (IA, p.35).

- ## Scope of the Impact Assessment

The IA analyses the overall economic impact of each of the options and sub-options outlined above for both the EU and the US, indicating in each case the expected GDP growth in both economies and the volume of exports. The IA also analyses the impact of trade liberalisation on sectoral competitiveness in the EU and the US, highlighting the sectors that would see an increase or a decrease in their output, providing a detailed table to this effect.

The sectoral impacts of a 'conservative' and an 'ambitious' FTA were also assessed in the electrical and electronic equipment, insurance services and motor vehicle sectors, where the largest potential impacts are to be expected. However, no analysis was made for the agricultural sector, which is commonly recognised as being one of the most sensitive sectors.

While recognising that some sectors (such as agriculture, electrical machinery, metal and metal product, other transport equipment) are expected to see a decrease in their output in the EU, no explanations are given as to the measures that will be taken to mitigate such negative effects. In addition, the Commission mentions that 'concerns were raised from a European perspective with respect to a certain number of sectors, such as meat producers, fertilizers, bioethanol and sugar. The concerns related mainly to fears of competitive advantages of the US industry over its European counterparts and subsequent negative impacts on EU industry'. However, these concerns were not further assessed in the IA. No cost-benefit analysis appears to be included, the IA to concentrating more on the benefits, and little on the costs and drawbacks.

The IA also contains a section on environmental impacts and a section on social impacts.

As far as environmental impacts are concerned, the IA examines three possible effects of trade opening on the environment: 'scale effects' (expansion or decrease of economic activity through trade), 'composition effects' (changes in production and consumption patterns), and 'technique effects' (improvement in emission efficiency). The Commission analyses in particular the impact of a comprehensive FTA (the other options being considered to have limited negative impacts) on the climate and climate change resulting from $CO2$ emissions, as well as the potential impact of all policy options on biodiversity, natural resources and waste, and the environmental consequences for firms and consumers. The IA concludes that 'even under the most extreme scenario (option C2), the impact on global emissions is expected to be small' and that 'the negative impact of the different policy options on waste, biodiversity and natural resources would be mitigated to some extent by benefits flowing from increased trade in environmentally sustainable goods and services, and increased cooperation between the two partners (IA, p. 49).

Regarding social impacts, the IA analyses the expected effects of the different options on welfare, including wages (which are expected to increase both for skilled and unskilled workers), indicating that 'only a comprehensive trade and investment agreement would allow for a substantial positive increase in welfare'. Gender effects are also briefly mentioned. The IA also provides a sectoral analysis of the impact on employment, recognising that 'the net job increases in some sectors will take place by drawing resources from other sectors where output is expected to fall' and that the 'strength of this effect will depend on labour mobility within the EU and between sectors'. The Commission indicates further that there are 'legitimate concerns that labour is not sufficiently mobile between the sectors and across Member States in the EU' and that 'as a consequence, there could be prolonged and substantial adjustment costs', which are however not quantified.

Finally, the IA includes a brief analysis of the impact on human rights.

The specific impact on consumers seems to have been left out of the IA, and the clear implication is that it would be positive.

- **SME test**

The expected impact on SMEs is explicitly included in the IA. The Commission expects SMEs to gain mainly from a comprehensive agreement, since regulatory compliance costs represent a bigger burden for them than for larger firms. In addition, the US is the most important market for internationalised European SMEs.

- **Impact on third countries**

An assessment of the economic impact of the proposal on third countries is included in the IA. According to the Commission, 'an ambitious FTA between the EU and the US is expected to raise total world income by 238 billion euros, of which 86 billion euros are expected to materialise in third countries' (IA, p. 44) (a 20% spill-over effect is assumed in the economic model used). The Commission assumes 'no major trade deviate effects for low income countries' and that 'the positive effects of a trade initiative between the two largest economies in the world are not at the expense of less developed economies' (IA, p. 45). In addition, according to the IA, the possibility of indirect spill-overs are the main driving force for the gains of third countries. These indirect spill-overs capture the possibility of third countries adopting the common standards agreed by the EU and the US, leading to lower costs and greater trade between them.

- **Subsidiarity and proportionality**

Common commercial policy and the negotiation of international trade agreements are areas of exclusive EU competence (Article 207 TFEU), therefore the principle of subsidiarity does not apply in this case. However, where the agreement touches on areas of shared or supporting competence, the issue of subsidiarity might arise.

- **Budgetary or public finance implications**

An FTA with the US would affect the EU budget through the loss of own resources in the form of custom duties. Any impact would depend on the level of ambition chosen for the trade policy initiative and the outcome of negotiations.

- **Administrative burdens**

The IA indicates that the administrative efforts necessary for implementation are different for each of the policy options (with the exception of the baseline scenario for which no additional costs are foreseen), and the complexity of implementation, depending on the extent of elimination or reduction of the trade costs resulting from non-tariff measures. The Commission does not provide any quantification of this effect, but says that 'a more ambitious outcome in terms of envisaged elimination and reduction of NTMs could lead to higher administrative costs (new legislation or adjusted regulation) in the short run, but would have mitigating effects on red tape and administrative burden in the long run' (IA, p. 54).

- **Stakeholder consultation**

Extensive consultation was held with stakeholders, including representatives of Member States, civil society and industry. The proposal was preceded by two consultation exercises: the first between February and April 2012 and the second between June and September 2012. The second consultation was organised specifically to support the present impact assessment. It gathered 114 contributions, a summary of which can be found in Annex 5 of the IA. Responses originated to a large extent in the EU, with a smaller number of contributions coming from the US. The results of the public consultation showed that stakeholders are generally highly supportive of a transatlantic initiative, which would take the form of a comprehensive agreement covering both goods and services.

'In a joint follow-up solicitation DG TRADE, DG ENTR together with the United States Trade Representative (USTR) and the Office of Information and Regulatory Affairs (OIRA) invited stakeholders to provide joint proposals on concrete measures to achieve greater regulatory coherence. Detailed joint submissions from EU and US industry have been received, among others, from the car, chemicals and pharmaceutical industry' (IA, p. 8). An ad hoc Civil Society Dialogue took place in Brussels on 20 March 2012 to gather civil society stakeholders' views regarding the objectives and priorities for a transatlantic initiative.

- ## Quality of data, research and analysis

The IA relies mainly on two studies commissioned by DG Trade, the Ecorys study of 2009 entitled 'Non-tariff measures in EU-US trade and investment' and the CEPR study of 2013, entitled 'Reducing Transatlantic Barriers to Trade and Investment' which was commissioned to update and complement the Ecorys study and to underpin the analysis of the present impact assessment. The analysis of impacts and the quantitative data obtained relies on the CEPR 2013 study which uses a multi-regional global computable general equilibrium model explained in annex 3 of the IA. The Commission clearly indicates that 'as with any model, it can only give indications of the impact that might result from assumptions specifically set in advance' (IA, p. 30).

Overall, the IA is very rich in quantitative data, especially - if not exclusively - on the benefits of an FTA, but does not accompany them with sufficient qualitative information, allowing the reader to understand how the results were obtained, nor does it contain an adequate assessment of the risks or drawbacks.

In addition, the provision of information on the results obtained with previous FTAs (for example with Korea) on GDP growth, job creation, wage increases, and consumer prices would have been useful to assess the credibility of the economic model used. A more detailed sectoral picture of the current trade situation between the EU and the US, highlighting the degree of liberalisation of the different sectors would have given a useful overview of the existing trade potential.

- ## Commission Impact Assessment Board

The Commission's IA Board issued its opinion on the draft IA on 20 November 2012, highlighting that the report should be improved in a number of respects: the problem definition needed to be enhanced by providing greater clarity on the most sensitive issues or sectors, the options had to be better linked to the problems, explanations had to be provided as to how the barrier reductions targets had been set, the quantitative modelling results had to be complemented with qualitative analysis, spill over effects needed to be better explained and the impact on Member States or regions described, as well as the impact on third countries, consumers, employment and investment flows. The IAB also recommended the report to be more balanced in terms of potential risks and benefits and to facilitate access to the sources/studies used for the analysis by providing their title in addition to the author name and, where possible, a web-link. Stakeholders' views also had to be presented more systematically throughout the IA. Most of these concerns do not appear to have been fully addressed, with the exception of the problem definition and the impacts on third countries and on employment.

- **Coherence between the Commission's legislative proposal and IA**

Since access to the proposal is restricted, it was not possible to verify the coherence between the proposal and the IA.

Author: Alexia Maniaki-Griva

Impact Assessment Unit
Directorate G for Impact Assessment and European Added Value
Directorate General for Internal Policies of the Union (DG IPOL)
European Parliament.

This note, prepared by the Impact Assessment Unit for the Committee on International Trade (INTA) analyses whether the principal criteria laid down in the Commission's own Impact Assessment Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work. This document is also available on the internet at:
http://www.europarl.europa.eu/committees/en/studies.html

To contact the Impact Assessment Unit, please e-mail: impa-secretariat@ep.europa.eu

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