

Brussels, 18 December 2009

## **Non-Tariff Measures in EU-US Trade and Investment – An Economic Analysis**

### **Highlights of the study**

#### What is the study about?

The study<sup>1</sup> was carried out at the request of the European Parliament. It identifies the most important Non-Tariff Measures (NTMs) that affect trade between the EU and the US, and estimates their economic impact. NTMs are all about regulations, from product-specific technical standards to economy-wide regulations that may hamper trade.

The study does not look at whether a specific NTM is justified or not, or whether one system of regulation is better than the other: legal and regulatory systems on each side of the Atlantic diverge because of historical and domestic policy reasons.

Instead, the purpose of the study is to estimate by how much regulatory differences increase the cost of doing business across the Atlantic, and to assess what impact they have on economic welfare in both economies. Such estimates derive from a number of assumptions and are based in part on perceptions from industry; their translation into figures involves an element of judgement on how to measure the impact of the reduction of individual NTMs and on whether and to what extent they can be reduced.

Why focus on NTMs? Because tariffs on both sides of the Atlantic are already very low and have become proportionately less of a problem for businesses. The real problem for exporters and investors are behind the border, in diverging regulatory systems. Further, whereas tariffs are relatively predictable, regulatory issues are much less conspicuous and their costs are more difficult to assess. And as one of the world's largest trade relationships, the overall costs can be enormous.

There is a public interest therefore in seeking to make these costs more apparent and estimating their magnitude.

#### What is the methodology used?

Estimating the trade costs of NTMs is a difficult exercise. The study moves away from purely statistical constructions and focuses on identifying the NTMs that matter most to industry. A large scale survey on both sides of the Atlantic was conducted in order to assess which NTMs companies perceive to have the most deleterious impact on their business. The survey also asked companies to give their assessment of the regulatory restrictions they face in their export

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<sup>1</sup> *Disclaimer: The study was commissioned by the European Commission (DG TRADE) at the request of the European Parliament. It was carried out by a team of consultants from Ecorys (NL), in close collaboration with a Steering Committee of experts from inside and outside the European Commission. The views and opinions expressed in the study do not necessarily represent those of the European Commission or the members of the Steering Committee.*

market. Based on the results of this survey the study presents a list of NTMs in 23 different sectors. It also provides indications of their economic cost.

The business survey attempts to measure the perceived trade restrictiveness (on a scale of 0 to 100) of NTMs in the destination market for exporters (the US and the EU) in 23 sectors (Table 1 in annex). This restrictiveness varies considerably depending on the sector, from as low as 18 (export of travel services from the US to the EU) to as high as 56 (export of airplanes from the EU to the US).

Comparing NTMs on both sides of the Atlantic is not a beauty contest: the study finds instances of NTMs that increase the cost of trade and negatively affect their competitiveness in both economies. The overall average level of trade costs of these NTMs is more or less equal in both the EU and US.

Unlike tariffs, which can in principle be eliminated, in most cases regulation cannot just be eliminated. Of course the two instruments have a different function: the main purpose of regulation is not to create compliance costs but to generate benefits for consumers and producers, which should far exceed compliance costs. However, when regulation differs between trading partners, it generates additional compliance costs for firms. Some of those costs can be reduced through convergence, harmonisation and mutual recognition in regulatory requirements. However, basic differences in legal tradition, approaches to regulation and institutions in charge of implementation often prevent full convergence. In fact, there are many reasons why full elimination of NTMs is neither feasible nor desirable. Therefore, often the most practical option is to seek a reduction in compliance costs.

The study examines the extent to which NTMs can realistically be reduced ("actionability" of NTMs) on the basis of survey results, views from industry associations and expert opinions. This is arguably a more subjective aspect of the study. Overall, it finds that only about half of the identified NTMs can potentially be reduced or removed. The study then draws two possible scenarios and compares their potential trade and economic benefits: Scenario 1 is based on an ambitious and optimistic full removal of actionable NTMs, while Scenario 2 is based on a more realistic partial removal of the actionable NTMs.

### What are the main findings from the study?

The main conclusion is that there are substantial economic benefits to be reaped from reducing the trade costs of transatlantic regulatory divergences (see Table 2 in annex). The headline figures for the ambitious scenario (Scenario 1) are as follows:

- For the EU, removing all actionable NTMs would translate into an increase in GDP (€12 billion per year) and exports (+2.1%). Sector-wise EU benefits would come mainly from gains in motor vehicles, chemicals, pharmaceuticals, food and electrical machinery.
- For the US, benefits from removing actionable NTMs are estimated at €1 billion per year for GDP and 6.1% for exports. US benefits would mainly accrue to the electrical machinery, chemicals, pharmaceuticals, financial services and insurance sectors.

Many factors contribute to the differences in outcomes between the EU and US economies. The US gains more in exports and the EU more in income. Differences in the initial volume of trade flows and in comparative advantages in specific sectors play a role. However, the model

used in the study covers the entire economy. It starts from the potential NTM reductions identified in the study, adds economy-wide NTM reductions and other cost-reducing measures to that, such as opening public procurement markets and aligning IPR related measures, and lets these effects work their way throughout the entire economy. This results in cheaper imports, higher economic efficiency and increased incomes far beyond the original 23 sectors covered in the study, as well as in stimulated investments and increased wages. The study shows that the economy-wide effects are much larger than specific sector NTM reduction effects. As a result, the overall economic outcomes can not just be explained on the basis of (sector-specific) trade and NTM patterns.

Tables 3 and 4 show expected changes in output and exports in the more ambitious scenario with full reduction of NTM trade costs. Although sector outcomes show declines in output and exports in some sectors, the overall impact on labour markets is positive. Labour markets in both EU and US would benefit from the NTM reduction and wages would increase in both economies.

While the study represents state-of-the-art economic research work on NTMs and the estimation methodology is validated, the figures in the study should not fully be taken at face value, as they are subject to error margins due to modelling and survey limitations. This is also indicated by strong estimate variations in some sectors, which should be read with particular caution. However, the study provides a glimpse into complex questions of regulatory differentiation between the EU and the US and in this context it calls for further examination of ways to reduce transatlantic trade costs to the benefit of businesses and consumers alike.

#### What are the possible implications for trade policy?

The study strengthens the case for reducing transatlantic regulatory differences by showing that we can thereby provide a much-needed boost to our economies.

Additionally, the study provides support and guidance for an ambitious transatlantic programme that addresses regulatory issues.

However, it does not provide a recipe for achieving these reductions in NTM costs. The scope for reducing or eliminating NTMs and the appropriate policy instruments and strategy to achieve this would require further examination. This issue will figure high on the agenda of the new European Commission.

The study weakens the argument for a Transatlantic Free Trade Agreement based on the removal of tariffs, since the trade costs of NTMs are shown to be significantly higher than the already low MFN tariffs in both the EU and US.

Priority, therefore, should be given to addressing regulatory issues instead of cutting tariffs in EU-US trade relations.

Finally, the findings and recommendations of the study reflect the objectives set in the EU's Global Europe trade policy strategy (2007). Global Europe already noted the importance of reducing regulatory barriers as part of the EU's trade policy agenda. It also made the link between the EU's internal reforms under the Lisbon Strategy and its external competitiveness. In the context of the debate on the EU's 2020 strategy, the link between domestic regulation and the overall openness of the European economy should be given greater priority.

## ANNEX

Table 1 Trade restrictiveness index

Sectors	Index of NTM restrictiveness (scale 0-100)	
	Into US	into EU
Travel	36	18
Transport	40	26
Financial services	30	21
ICT services	20	19
Insurance	30	39
Communication	45	27
Construction	45	37
Other business services	42	20
Personal & cultural services	36	35
Chemicals	46	53
Pharmaceuticals	24	45
Cosmetics	48	52
Biotechnology	46	50
Machinery	51	37
Electronics	31	20
Office & ICT equipment	38	32
Medical & measuring equipment	49	45
Automotive industry	35	32
Aerospace	56	55
Food & beverages	46	34
Iron, steel and metal products	36	24
Textiles clothing & footwear	36	49
Wood & paper	30	47
<b>Simple average</b>	<b>39</b>	<b>36</b>

*N.B. Due to the nature of these NTM estimates, these figures are subject to varying levels of confidence and should therefore be interpreted with caution.*

Table 2 Summary of **macroeconomic changes** following NTM reduction

	<b>Ambitious Scenario (full reduction in actionable NTMs)</b>	<b>Limited Scenario (partial reduction in actionable NTMs)</b>
<b>Real income, billion €(\$)</b>		
US	40.8 (53.0)	18.3 (23.8)
EU	121.5 (158.0)	53.6 (69.7)
<b>Real income, % change</b>		
US	0.28	0.13
EU	0.72	0.32
<b>Value of Exports, % change</b>		
US	6.06	2.68
EU	2.07	0.91
<b>Value of Imports, % change</b>		
US	3.93	1.74
EU	2.00	0.88

Table 3 **Changes in output** (in %) by sector after NTM alignment (ambitious scenario – Long Run)

	US	EU
Processed foods (food & beverages)	-2.1	0.9
Chemicals, cosmetics, pharmaceuticals	-3.3	2.2
Electrical machinery (electronics, OICE)	29.2	-5.5
Motor vehicles (automotives)	-1.4	5.7
Other transport equipment (aerospace)	1.6	-0.9
Other machinery (MMTA)	-1.1	-1.9
Metals and metal products	-0.1	-0.5
Wood & paper products	-0.4	0.0
Other manufactures	-0.3	0.1
Water transport	0.4	0.5
Air transport	0.3	0.3
Finance	0.1	0.4
Insurance	-1.0	1.2
Business services & ICT	0.3	0.5
Communications	0.4	0.2
Personal, recreational & cultural services	0.4	-0.1
Construction	0.4	0.8

Table 4 **Changes in exports** (in %) by sector following NTM alignment (ambitious scenario – Long Run)

	US	EU
Processed foods (food & beverages)	3.0	5.4
Chemicals, cosmetics, pharmaceuticals	11.8	6.2
Electrical machinery (electronics, OICE)	41.9	-4.6
Motor vehicles (automotives)	9.1	10.7
Other transport equipment (aerospace)	16.9	4.2
Other machinery	-1.8	-2.6
Metals and metal products	13.8	2.7
Wood & paper products	10.9	1.6
Other manufactures	-0.9	-0.4
Water transport	1.6	0.9
Air transport	1.1	0.6
Finance	4.9	2.6
Insurance	2.4	5.9
Business services & ICT	3.4	0.6
Communications	9.5	0.3
Personal, recreational & cultural services	5.4	-0.8
Construction	2.6	0.2