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The evolution of the transatlantic economic relationship has to be considered within the framework of a changing global environment. The bilateral partnership between the United States and the European Union is still dominant both in terms of trade and investment, although it is becoming less relevant in terms of distribution of global GDP. The Transatlantic Trade and Investment Partnership (TTIP), which should be finally signed by early 2015, is the main element of potential convergence between the EU and the US in the near future. However, we envisage two main stumbling blocks. The increasing importance of the Pacific region for the US and the domestic pro-

blems the EU is facing in terms of sluggish growth and challenges to deeper economic integration might reduce the EU's attractiveness as a strategic partner. The role of China, as the third main economic player on the global stage, cannot be neglected. However, it is too early to predict whether China will play along the new regulatory standards that the TTIP will set. For these reasons, the transatlantic economic relationship is still likely to maintain the status of an "enduring partnership", although uncertainty related to the final outcome of the TTIP and the economic recovery in the EU suggest that it might be heading to a more "functional relationship" scenario.

The Future of the Transatlantic Economic Relationship: Opportunities and Challenges towards the TTIP

Davide Tentori and Myriam Zandonini



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EU

US

China

Foreign trade

FDI

TTIP

Introduction

The analysis of the evolution of the transatlantic relationship has to be considered within the framework of a changing economic global environment. Emerging market economies, foremost China, are increasing their relative and absolute weight in the world economy. The traditional set of alliances and institutions that form part of the Bretton Woods and the WTO system have been questioned and their effectiveness is diminishing.¹ Global economic interdependences are deepening and interconnectedness significantly increasing. On the flipside, this will likely strengthen systemic vulnerabilities as it increases the risk of contagion when crises occur (IMF 2013a).

The transatlantic relationship could evolve in many different ways. As a reference point, we will consider the three scenarios formulated by Tocci and Alcaro (2012, 2014) along a continuum between a structural separation and a close fully-fledged partnership and assess their likelihood in the economic realm. The first is a structural drift, which implies that the two actors are torn apart by diverging, irreconcilable interests and identities; at the other end of the spectrum there is an enduring partnership, in which the two agree on long-term visions and policy platforms; and in between they consider a functional partnership, where the EU and US agree and converge on a case-by-case basis in certain sectors where both actors would have gains and maintain the existing cooperation patterns and institutions.

What are the perspectives for the transatlantic relationship? We argue that there is a strong, long-lasting partnership which might be slowly downsized, at least in relative terms, in the medium term. The relationship is currently still the strongest bilateral partnership in the world: the European Union (EU) and the United States (US) are the biggest trade and investment partners. The long-standing economic partnership could be further strengthened by a successful signing of the Transatlantic Trade and Investment Partnership (TTIP), which would lead to converging policies in trade and investment. However there are signs of a slow but steady decline in the

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¹ We mean here: IMF legitimacy questioned (and on-going reform of quota and governance system), the failure of the multilateral system in the DDA, among others.

relative importance of the EU on the world stage and in the eyes of its transatlantic partner. Albeit maintaining a “special relationship” status, the EU risks being a less relevant partner to the US in a world where ties with emerging regions are becoming increasingly important. This is especially relevant as the US is moving towards a full recovery after the 2007-08 global financial crisis, whereas recovery has been sluggish in the EU. At least three main reasons support this assumption: the changing global environment (power shift towards emerging market economies), the strategic importance of the Pacific region, particularly for the US, and the importance of domestic factors and politics in both the EU and the US.

The paper starts by assessing the status of the transatlantic economic relationship within the changing global framework with respect of macroeconomic, trade and investment integration. It then focuses on the economic performance in the EU and the US, highlighting risks of a structural divergence. The following section is dedicated to the main element of (potential) convergence in the short-medium term, represented by the TTIP, which might disclose sizeable opportunities for closer economic integration between the EU and the US. The paper then analyses potential drawbacks and external challenges to the TTIP, represented by the rising importance of other regions, namely the Pacific area (with which the US is engaged in negotiations for another Free trade Agreement, the Trans-Pacific Partnership - TPP), and China. The final section assesses to which of the three scenarios recalled in the above the transatlantic relationship is moving towards.

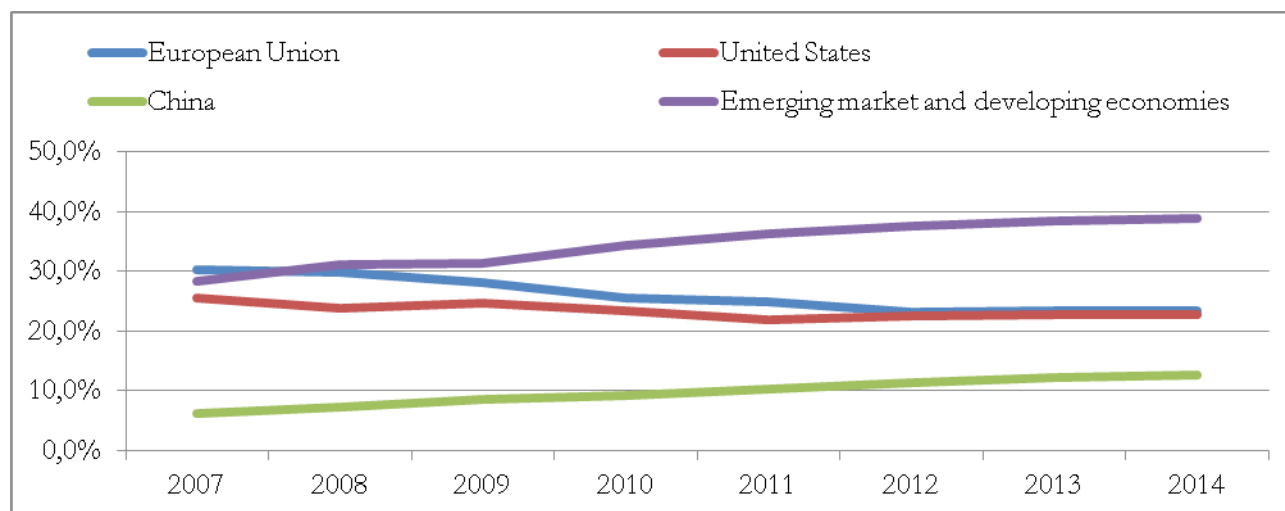
1. The Global Environment

The US and the EU still play a central role in the global economy and international relations. However, the global financial crisis of 2007-8 helped accelerate ongoing trends in the redistribution of economic power, increasing the importance of China and Emerging Market Economies (EMEs). In particular China doubled its share on world GDP from 6.2% in 2007 to 12.7% in 2014 (expected) (Figure 1) and might become soon the main global trading actor in terms of merchandise. In 2012 China’s total value of exports and imports reached 3.86 trillion dollar, against a value of 3.88 trillion dollar in the US.² In early 2014, statistics released by the Chinese authorities claimed that China overtook the US with a total value of exports and imports of 4.16 trillion dollar (Anderlini and Hornby 2014), although these data still have to be confirmed. Taking into account also trade in services, the EU is still the world’s main player and is ahead the US (Hamilton and Quinlan 2014).

In terms of global economic governance, multilateralism has progressed further in macroeconomic and financial policy coordination but less so in terms of trade liberalization. Upgraded to the level of a summit of heads of State in 2008, the Group of 20 (G20) has managed to enhance macroeconomic coordination through mechanisms of reciprocal surveillance which proved to be effective especially in the immediate aftermath of the global financial crisis (Subacchi and Pickford 2011). Operating in close cooperation with the G20, the Financial Stability Board (FSB) and the International Monetary Fund (IMF) provided support in terms of financial regulation and macroeconomic surveillance (Pickford 2013). As the two biggest global economies, the EU’s and the US’s role has been central in pushing the G20 agenda forward, and they are among the G20 members with the highest compliance rate to the decisions taken at the summit (IORI and G20 Research Group 2012). However, as the urgency originated by the crisis has reduced over time, the G20’s effectiveness seems to be waning (Strube 2014).

² See trade profiles for China and the US in WTO Statistics database: <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN,US>.

• Figure 1 | Distribution of global GDP (% , 2007-2014-est.)



Source: Chatham House elaboration on IMF data.

On the other hand, despite the moderate success of the Bali agreement at the end of 2013, talks of trade liberalization at the WTO level are at a standstill, given the prolonged stall of the Doha Round.³ We are currently in a multilateral framework wherein achieving further liberalization is not a viable option; where bilateral, or at best, regional agreements are the backbone of today’s trade liberalization process;⁴ and, at the same time, where we are experiencing a so-called “quiet return” of protectionism (Evenett 2013). For instance, between June 2012 and May 2013 431 protectionist measures have been put in place, 30% of which by G8 nations (Evenett 2013).

Both the US and the EU have engaged in a strategy of bilateral or mega-regional agreements. On the European side, at the end of 2013 the EU has finished negotiating ten Free Trade Agreements (FTAs) that have yet to enter into force, and has in place FTAs with some 50 partners, mainly with developing countries, but also with Japan, Canada and the US, as well as with China for an investment partnership⁵ (European Commission 2013a). Similarly, the US has 20 bilateral FTAs in place (USTR 2014). Two major negotiations are under way at the global level that both include the US, namely the above- mentioned TPP, where the US is engaged with other 10 countries to achieve their long-standing ambition of building a free trade zone in the Asia-Pacific region, and the TTIP with the EU.⁶

In terms of foreign direct investment (FDI), for the first time developing countries replaced developed economies as the main FDI recipients (UNCTAD 2013). The pace of the “natural” catch-up process undertaken by EMEs has been magnified by the financial and economic crisis which hit both the EU and the US, leading to a 10% loss of global GDP’s share since 2007 in the EU (IMF 2013b). However, the transatlantic partners are still playing a crucial role in the global network of economic relationships, accounting for over 45% of the world economy, and have strong and long-standing trade and investment ties. US-EU merchandise trade totalled an estimated 650 billion dollar in 2012. Investment is still the main economic driver of the relationship, even if it is slightly declining in

3 Although the recent Bali agreement, which represents the first global trade deal reached by the WTO since the Doha round was launched in 2001, marked some important steps towards trade facilitation and the easing of trade barriers (Karmakar 2013a and 2013b).

4 They are also called super-RTAs. Also there have been talks about “minilateral” agreements. Naim (2009) described minilateralism as bringing “to the table the smallest possible number of countries needed to have the largest possible impact on solving a particular problem.”

5 The EU and China agreed to start negotiations but haven’t negotiated anything yet.

6 Another mega-regional trade agreement is the ASEAN+3, which we will not discuss in detail in this contribution.

relative terms. For instance, in absolute terms, the US is still the main partner of the EU and accounted at the end of 2011 for 29% of EU FDI stocks abroad and for 35% of FDI inwards.⁷ In 2011 EU's investment flows to the US were still seven times larger than the flows directed to China (Hamilton and Quinlan 2014).⁸

2. A Health Check to the Transatlantic Relationship: Discrepancies in Growth Performance, But Still Very Close Partners

Although both the US and the EU economies were hardly hit by the crisis, data show that the two regions' experiences were different, and highlighted already existing discrepancies in growth performances (Figure 2). While the US managed to recover from the hard landing of 2009 and recorded an average annual growth of 2.3% from 2010 to 2012, the EU experienced two recessions, in 2009 (-4.4%) and 2012 (-0.3%). The perspectives for the two areas also look quite different. According to IMF estimates (2013c), the US will grow on average by 3.1% from 2014 to 2018, while the recovery in the EU will be weaker, with an annual growth of 1.6% in the same period. The prolonged economic crisis in the EU, which unveiled underlying structural problems in the construction of the euro area, forced EU institutions to give priority and to dedicate significant resources policies to the solution of its internal weaknesses. Macroeconomic adjustment was critical both in the EU and the US, but the latter reacted swiftly and recovered growth in the immediate aftermath of the crisis thanks to the massive injection of money in the banking sector and the stimulus package (Suominen 2013).

The divergence in growth performance has become structural. For instance, the rise of structural unemployment in peripheral countries of the euro area such as Spain and Greece⁹ signals a reduction in capacity utilization and in the activity rate of the economy. Structural unemployment in the euro area is currently at 10.2% but is much lower in the US at 6.1%.¹⁰ This has significant implications on the evolution of the EU-US relationship. A vicious circle linking unemployment and weak domestic demand would reduce the scope and the attractiveness to boost trade and investment with the EU, and also in the eyes of its transatlantic partner. A weaker EU might become less attractive for the US, which would increasingly turn towards other regions.

The transition process towards a technology-driven economy is another case in point of the diverging routes the EU and the US are taking. The US is still the main non-EU R&D investor in the EU: EU-based companies account for 30.6% of the top R&D companies in the world, compared to 34.3% for the US and 22% for Japan (Hamilton and Quinlan 2014). However, the EU is lagging behind the US and other developing regions in terms of innovation and performances in higher and scientific education (Renda 2013). The annual expenditure per capita on R&D activities is 534 euro in the EU, while it is 944 euro in the US.¹¹ Disparities in R&D performance are also evident within the EU itself between northern and southern EU countries: for instance, in southern Europe, R&D intensity is less than half of Scandinavian countries, Germany and Austria (Erber and Hagemann 2013). A bigger effort would be required by the member States, in coordination with the EU institutions, in order to

7 Eurostat, *EU direct investments - main indicators*, http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=bop_fdi_main.

8 US FDI outflows to Europe were 188 billion dollar in 2012, a 17% decline from 2011, but still the third strongest annual level on record. In 2013, US FDI outflows to Europe totalled 200 billion dollar, 9% more than in 2012. US FDI inflows from Europe were 105 billion dollar in 2012, an 18% decline from 2011. Europe accounted for roughly 65% of total US inflows in 2012. In the first half of 2013, US FDI inflows from Europe totalled 49 billion dollar, down 13% from the same period in 2012. Europe accounted for 73% of total inflows during this period (Hamilton and Quinlan 2014).

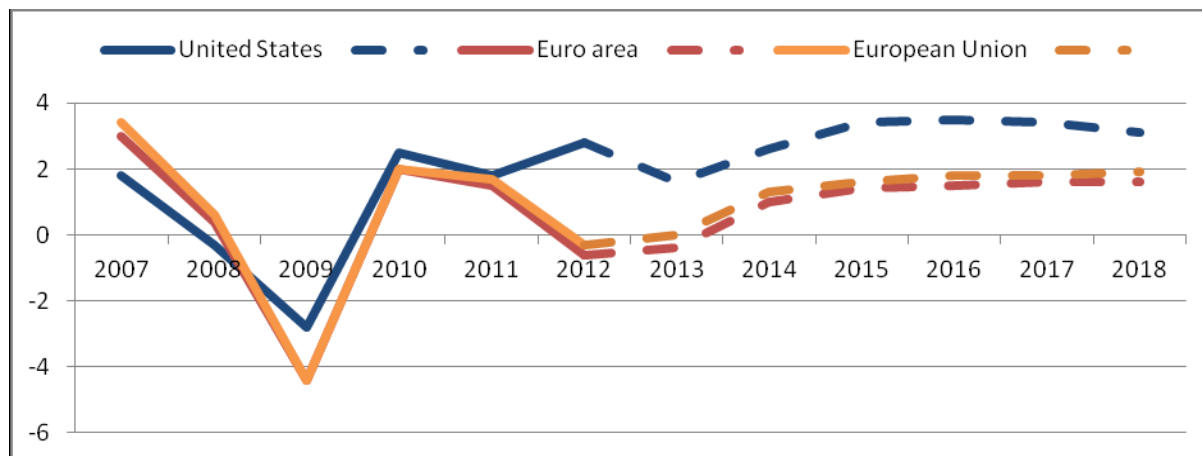
9 Respectively from a 13.3% and 10.3% during the period 1999-2008 to 21.5% and 16.8% in 2014. OECD Statistics: *Structural unemployment, forecasts (EO95, May 2014)*, <http://dx.doi.org/10.1787/888933052270>.

10 Ibidem.

11 Eurostat, *Total intramural R&D expenditure (GERD) by sectors of performance and NUTS 2 regions*, http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=rd_e_gerdreg.

successfully implement the EU 2020 Agenda, which set the target of achieving investment in innovation equal to 3% of the EU GDP by 2020.

• Figure 2 | The US and the EU's growth patterns (2007-2018)



Source: Chatham House elaboration on IMF data.

Moreover, domestic factors impact on the future of the economic relationship. The EU, in particular the euro area, is engaged in moving towards more integration, *in primis* with regards to steps towards a Banking Union. It is a major opportunity and challenge at the same time for the Monetary Union. A positive outcome would reduce financial fragmentation in the euro area and keep it safe from risks of collapse (although it is unlikely that a complete Banking Union is enforced in the short term). It would also help reduce the risk of new economic and financial crises, but as a “side effect” it might exacerbate the “two-speed” integration trend, or even trigger more dramatic divisions in case a “Brexit” (i.e., Britain leaving the EU) should take place. The status of the UK within the EU¹² is particularly “sensitive” with respect to the completion and current status of the single financial market. The potential renegotiation of the UK’s membership or its potential exit could be a blow to the relationship between the US and the EU from the economic (and especially financial, as it will be described in next section) point of view. A recent survey of a hundred business leaders demonstrates that they want the UK to be in the Single Market - an overwhelming 84% indicated that they wanted the UK to remain a member of the EU and agreed that EU membership economically benefits the UK as a whole (TheCityUK 2013b:3).¹³ In a different survey by TheCityUK, decision makers specifically cited access to markets in the EU as a core reason for choosing the UK over other financial centres (TheCityUK 2012:12).¹⁴

Given the crucial role of London as a “bridge” between the two sides of the Atlantic, both in political and financial terms, a less integrated EU might indirectly have negative consequences also on the transatlantic relationship. Moreover, another problem undermining the EU’s active role in the coming years is represented by the legacy of the process of macroeconomic adjustment. This contributed to increase people’s skepticism towards the EU and especially the euro area.¹⁵ In other words, austerity measures, which were implemented in an attempt

12 The government led by Prime Minister David Cameron promised in early 2013 that, in case of a re-election in 2015, a referendum about the exit of the UK from the EU will be held by 2017. However, it remains unclear whether the consultation will actually take place, in case a different majority, led by the Labour Party, wins the next general elections.

13 The survey was undertaken with Ipsos MORI, interviewed 101 UK based CEOs, chairmen, CIOs, board members, directors and partners of firms from across the sector.

14 See also TheCityUK 2013a.

15 The latest Eurobarometer survey shows that, despite the crisis, overall attitudes towards the euro have remained strongly positive, both in the core and periphery of the euro area (with 63% overall in support), while they have sharply turned negative outside the currency bloc (only 42% are in favour). However, the survey also shows that lack of trust in the EU overall has dramatically increased from 36% in 2007 to 58% in 2013 (European

to put the euro area's house in order, might undermine the readiness of European publics to accept why a more deeply integrated Union is needed (Kahn and Kupchan 2013b). Hence, the rise of "anti-euro" parties and movements not only in southern countries but also in France, Germany and the Netherlands and their potential successful results in the European elections of May 2014 might slow down the integration process.

3. Trade Relations as a Point of Convergence

Among the panoply of economic and financial relations and agreements that bind the EU and US together, we see trade relations as the main new element of convergence in the next few years.

Despite remaining the world's two most integrated economies and each other's most important partner, bilateral trade relations had not shown an increasing trend of any significance during the last decade. From 2004 to 2013 exports from the EU increased by an annual average of 2.85% while imports increased by 2.45%.¹⁶ On the other hand, the rise of the exchange EU-China has been much sharper, recording an annual average growth of 14.04% in exports and of 11.03% in imports.¹⁷ The negotiations towards an agreement on trade and investment, within the framework of the TTIP, have therefore the potential of bringing significant gains to both economies.¹⁸ The TTIP revolves around three pillars: market access, the regulatory cluster and rules issues (USTR 2014). A comprehensive agreement would enhance GDP growth (between 0.5 to 3.5 % - depending on the degree of integration) and increase competition among companies on both sides. It could bring significant economic gains for the EU as a whole, approximately 88.7 to 155.1 billion dollar a year until 2027, and for the US, 64.4 to 123.5 billion dollar a year (Karmakar 2013a and 2013b, Francois 2013, European Commission 2013c). Leading to the creation of the biggest Free Trade Area in the world, it would also set new common standards and regulations other countries should comply to if they want to maintain their market shares in the US and EU (Tentori 2013, Alden 2013). Official forecasts envisage the potential creation of 15,000 new jobs for each additional billion euro in terms of bilateral trade (European Commission 2013c).

By promoting international competitiveness, jobs and growth in the partner countries, the TTIP will allow the US and EU to set the rules on critical emerging trade issues like regulatory standards. It would increase market access through the elimination of barriers to trade and investment in goods, services and agriculture (which are still remarkably high in this sector and amount to 205% on some items exported from the US to the EU), and the further opening of government procurement markets. It would also enhance regulatory coherence and cooperation and set rules and standards in new areas such as FDI, Intellectual Property Rights (IPR), labour and the environment. Both partners could obtain significant economic advantages above all through the removal of Non Tariff Barriers (NTBs). Tariffs are already quite low (3.5% on average) and therefore the impact of their further reduction would be negligible (Felbermayr et al. 2013). Removing NTBs, instead, would mean improving market access in order to ease trade, services, investment and procurement, above all with respect to health and safety standards.

Commission 2013b:125, 75).

16 European Commission DG Trade, *USA - Trade Statistics*, <http://trade.ec.europa.eu/doclib/html/113465.htm>.

17 European Commission DG Trade, *China - Trade Statistics*, <http://trade.ec.europa.eu/doclib/html/113366.htm>. Although bilateral trade between the EU and China started from much lower levels at around 120 billion euro in 2002, while bilateral trade with the US was already at around 450 billion euro.

18 It has to be noted that some argue that TTIP will only be a part, and a relatively small one, of the economic relationship of the US and the EU (Whyte 2013). Many other economic and financial initiatives - and other channels of cooperation and consultation - will continue to operate in parallel to the implementation of any comprehensive trade accord (Johnson and Schott 2013).

TTIP negotiations carry a great deal of significance for determining whether the Atlantic becomes narrower or wider. The announcement of the offset of bilateral talks spurred great enthusiasm about its importance on the future of transatlantic economic (and overall) relations, as shown by the mention of President Obama in the State of the Union in January 2013.¹⁹ Asked as part of the Transworld elite survey²⁰ about the current status and the future of the transatlantic relationship, the majority of the US (63%) and EU (65%) elites agree that that the negotiations on the TTIP would help the national economies grow. However, business leaders seem to see the TTIP less positively than the social and political elites (54% in the EU and 49% in the US) (Transworld 2014).

In aggregate terms, all forecasts seem to agree that the TTIP would represent a positive-sum game for both the US and the EU. A bilateral agreement between two large entities is likely to produce higher benefits than an asymmetric FTA between a small and a big one. These features provide an important “platform” to build great benefits upon. However, a more accurate analysis across industrial sectors would help clarify potential winners and losers. It is important to define that bilateral transatlantic trade is mainly intra-industrial (which is good to promote competition between firms operating in the same market) and in many cases intra-firm: estimates have suggested intra-firm trade represents around a third of total transatlantic trade (Erixon 2010). Half of all US foreign affiliates are in Europe and 60% of the assets held by US foreign affiliates are in Europe. The equivalent figure for EU affiliates in the US is 75% (Hamilton and Quinlan 2014). Therefore, we see two main advantages of opening up the markets. First, enhanced competition can bring prices down, force companies to improve their competitiveness with benefits for productivity and for the consumers. Second, Multinational Companies can avoid paying tariffs or bear NTBs to get access to both markets, which means a considerable reduction of their costs.

The main sectors involved in the negotiations are machinery and equipment, chemicals and pharmaceuticals, and agriculture. The example of car manufacturers is revealing of the benefits both for producers and consumers: defining common standards in terms of components and safety tests would allow reduce production costs. Also third parties (manufacturers from other countries not involved in the agreement) would benefit, being able to sell the same type of vehicle in both markets. Another market is airline routes in the US: EU airlines are currently not allowed to hold routes in the US domestic market. Changing public procurement rules would open up the market to European companies willing to operate within the US. This would bring about increased competition and potentially reduction in prices and fares. Agriculture is a still heavily protected and subsidized sector both in the EU and the US: tariffs are currently much higher than in other sectors at an average of 18%, with distortionary effects on prices which affect consumers and external producers (Costa et al. 2009). Agriculture will probably be the most difficult garble to resolve, also because it involves health and safety standards issues. The impact for consumers and producers would be mixed. In theory lower tariffs would mean also lower prices. However, removing subsidies to producers in sectors like dairy and meat production might induce them to cut the production down (European Commission 2013c) in order to limit supply and keep prices high.

The TTIP could positively affect both sides of the Atlantic also by helping them preserve their comparative advantages and stay at the upper stages of the Global Value Chains (GVCs) (Whyte 2013). Global trade today is increasingly centered on GVCs, which identify the full range of activities that firms undertake to bring a product

19 “And tonight, I’m announcing that we will launch talks on a comprehensive Transatlantic Trade and Investment Partnership with the European Union - because trade that is fair and free across the Atlantic supports millions of good-paying American jobs.” (White House 2013b).

20 The Transworld Elites survey was carried out between 6 September 2013 and 4 February 2014 in the US and in six European countries (France, Germany, Greece, Italy, Poland, and the UK). The elites (2014 people in total) have been selected from three target groups: the social sector (media, academics, think tanks, trade unions), politicians (elected representatives and their chiefs of staff in the US, ministers of departments who were relevant to the survey, senior politicians who are on committees relevant to the survey members of the European Parliament), and the senior business decision-makers, with particular reference to the small and medium enterprises (SME).

or service from its conception to its end use by final consumers. More than half of world manufactured imports are intermediate goods and 70% of imported services are intermediate services (Backer and Miroudot 2013:5). GVCs are so developed because trading costs have sharply decreased. In the EU there is strong integration within GVCs but, over the course of the last few years, the EU has lagged behind the US in terms of value added, moving downwards GVCs especially in the automotive sector (Riad et al. 2012). Further reduction of trade barriers would help enhance integration and disclose opportunities of complementarities coming from intra-industrial and intra-firm trade. Moreover, as trade in GVCs takes place especially between Transnational Corporations (TNCs) and their affiliates, also Small and Medium Enterprises which operate as suppliers to TNCs could benefit from the TTIP. To give an example, in the automotive sector, GVCs are very integrated both in the EU among their reciprocal members (Galar 2013). As the US is the EU's main trading partner (and vice versa) in terms of value added, TTIP could allow for further integration and value creation.

The negotiations are riddled with obstacles. A trade-off between comprehensiveness and effectiveness lies in the background of the deal. Reaching a fully-fledged agreement could prove too ambitious, given the broadness of the agenda and the short timetable which was set. Disagreement on single controversial issues on the agenda could end up watering down the final deal or the extent and depth of its measures and significance. In particular, there are three major stumbling blocks on the table: agreeing on tariffs and quotas in the agricultural sector, harmonizing divergent regulatory standards that make it difficult for goods and services developed for one market to be sold in another (particularly, the reduction of costs in administrative procedures and divergent regulations, the so-called non tariff barriers - NTBs), and liberalising services and public procurement.²¹

Harmonizing regulations is going to be a big issue at stake when measuring the success of the relationship. Although there has been growing exchange of information and cooperation on standards, the experience in important sectors, such as automotive safety and emissions standards, indicates that the long-delayed, much-needed standardisation is not easy to achieve. Safety and environmental standards are not the same in the EU and the US, which has given car manufacturers protection to their specific interests (Karmakar 2013a and 2013b). Binding agreements on the issue have been postponed for years as both parties are vehemently reluctant to sacrifice their interests. A diminished effort in this area would imply less market openness and less willingness to exercise leadership for the world trading system, with negative consequences also for countries outside the EU and the US, especially large emerging economies (Erixon 2013).

Another potential drawback of the negotiation process is that the urgency and impulse to reach an agreement in a short time might lead to a sub-optimal deal. It is increasingly unlikely that it will be reached within the time frame suggested (end of 2014 and signing in early 2015).²² The timeframe will be inevitably expanded by what is called by EU officials as the *legal scrubbing process* of converting the agreement in binding legal text and to translate it into all the EU's official languages, which will take at least two years.²³

21 Despite the WTO states clearly that domestic and foreign companies should be treated equally in all bid processes, the US currently holds 50 different procurement codes in each Federal State, many of which include a "Buy America" provision (Kolbe 2014). For instance, foreign airlines are not currently allowed to establish routes for internal flights in the US.

22 Negotiations started in February 2013. Negotiating groups set out respective approaches and ambitions in 20 various areas that the TTIP is set to cover, including custom duties and technical standards for goods produced on both sides of Atlantic. A first round of talks was completed in July 2013 (Washington, 8-12 July). A second round followed in November 2013 (Brussels, 11-15 November - initially scheduled for October but postponed due to the US government shutdown), which focused on trade rules and the regulatory component of the TTIP that will feed into a political review in January 2014. A third round was completed in December 2013 (Washington, 16-20 December). A fourth round of negotiations took place in March 2014 (Brussels, 10-14 March). However, frictions arising between the two sides might delay the negotiation process postponing a final deal to 2015. For instance, mention to reaching an agreement by the end of 2014 have been dropped in the fourth round of talks (March 2014).

23 See the public hearing by Mauro Petriccione, Director of the European Commission DG Trade for Asia and Latin America, before the House of Lords on 23 January 2014: "The agreement with Korea took a little longer than two years between the political breakthrough and implementation by the Council. We have agreements with Central America that took a bit more than two and a half years. We expect this [TTIP] to take about two years." (Petriccione 2014).

Moreover, the agenda on the table of the negotiators looks extremely ambitious. There are talks about adding further areas to cover in the negotiations. By expanding the agenda, particularly if adding financial services regulation, both parties would increase the risk of watering down the content of the final deal. At the same time, we see benefits in including financial regulation issues in the final deal in the form of a “living platform” that could be the basis for further integration in this area and convince other parties to comply to the new set of rules the transatlantic partners might agree on (Baily and Elliott 2013). There is some reluctance on the side of the US Treasury, as it could become an “unnecessary and unproductive distraction for the TTIP” (Johnson and Schott 2013:10), not least because harmonization of financial regulation and reciprocal transparency have been already discussed multilaterally at the G20/FSB level. On the contrary, the European Commission recently pushed to include financial regulatory issues in the agreement, proposing a “framework for regulatory cooperation in financial services” (European Commission 2014).²⁴ Including financial regulation in the deal might have positive implications for the role of London as the “gateway” to Europe from the US, in a moment where the UK’s membership in the EU is being questioned and there is the possibility of a referendum on the UK membership of the EU in 2017, as mentioned in the previous section (Baily and Elliott 2013, European Commission 2014). The UK is a crucial entry point for US companies to the EU and is a gateway to Europe both from the outside and from inside the UK, especially given the importance of London as a financial centre.²⁵ The UK shares with the rest of the EU and the US roughly the same value of its trade surplus in financial services.²⁶ Therefore, even taking into account risks and potential drawbacks, it might be useful to put financial regulation on the negotiators’ table as reaching an agreement in this sector might disclose benefits to the relationship overall.

Lastly, potential risks of trade diversion should be taken into account. If trade diversion were sizeable, the net effect of an agreement on the two economies would be close to negative. Given that the TTIP will be mostly an intra-industrial trade agreement, it is difficult to foresee a substantial risk of trade diversion which could harm developing countries, whose production structures are less sophisticated. However, TTIP would be difficult to get accepted by many actors in the EU that today have vested interests in maintaining current relations with Asian countries (Erixon 2013), especially the most developed ones like South Korea and Japan.

4. Searching for Other Partners? The Strategic Importance of the Pacific Region...

Ongoing geopolitical and geoeconomic trends show that a shift of global economic power from the Atlantic to the Pacific region is taking place (see section 1). South-East Asian countries, as well as the Latin American ones on the Pacific coast, are among the most dynamic actors on the global economic stage. The Pacific region, as well as the US, has performed much better than the EU in terms of GDP growth over the last few years and predictions show a similar trend will continue (Figure 3).

²⁴ This proposal includes the definition of internationally-agreed standards for regulation and supervision, mutual consultation prior to the adoption of new financial measures affecting the other party, a joint examination of the existing rules aimed at assessing whether they are barriers to bilateral trade.

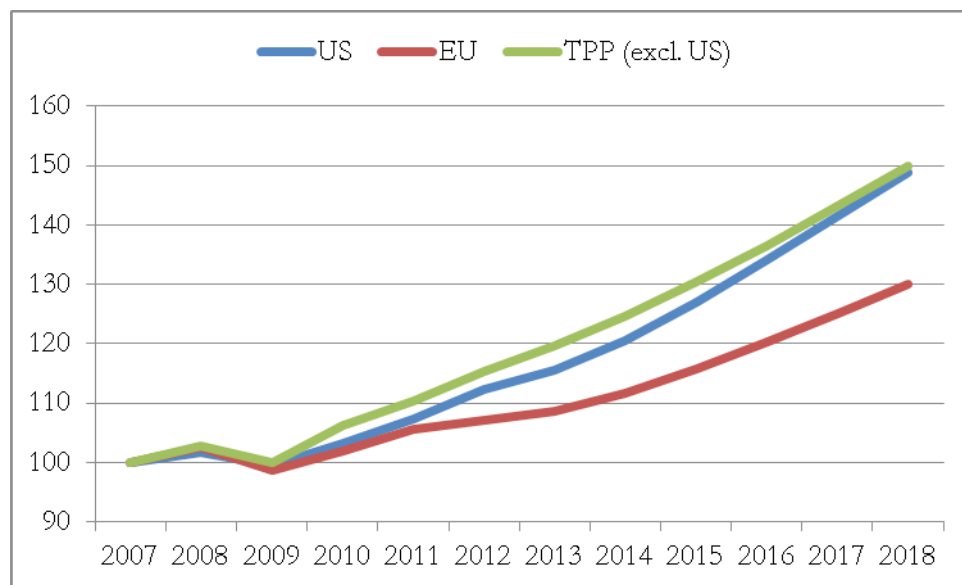
²⁵ The UK houses 74% of the EU’s wholesale financial markets (TheCityUK 2012:12).

²⁶ In 2011, 37.7% of the UK’s trade surplus in financial services (17.6 billion out of 46.7 billion British pound) was derived from trade with other EU Member States, compared to 25% derived from trade with the US (11.7 billion out of 46.7 billion British pound). See TheCity UK 2012:12.

As mentioned in the above, eleven countries in the region²⁷ are currently engaged with the US in negotiation rounds towards the signing of a TPP towards facilitating market access for goods, services and agriculture and around intellectual property rights, rules of origin, public procurement rules, labor and environmental standards. Given the high degree of complementarity between the twelve parties involved, a comprehensive TPP will allow members to rely more on Global Value Chains (GVCs). Smaller and/or less developed countries (such as Singapore, Malaysia, Vietnam) tend to use foreign inputs more intensively and to be positioned more “upstream” along the value chain, producing raw materials or intermediate services more at the beginning of the production chain (Backer and Miroudot 2013).

From the US perspective, TPP serves several strategic goals in US trade policy. It is the leading trade policy initiative of the Obama Administration, and is a clear manifestation of the Administration’s *pivot* to Asia. If concluded successfully, it will shape the economic architecture of the Asia-Pacific region by harmonizing existing agreements with US FTA partners,²⁸ by attracting new participants, and by establishing regional rules on new policy issues in the global economy. TPP might therefore foster economic relations in the Pacific Region for two main reasons. Firstly, developing countries in South East Asia and Latin America are growing fast and their domestic markets are in rapid expansion, which opens up a wide range of opportunities to deepen trade and investment relationships. Against this background, the EU risks losing attractiveness and relevance to US business and consumers in the future. Current integration between the US and Pacific countries in GVCs is lower than with the EU. As the Asian supply chain is more dispersed (Riad et al. 2012), TPP would help reduce its vulnerability to trade disruptions and potentially establish stronger linkages between upstream and downstream positions of the chain. Moreover, a successful deal will lead to further integration in the value chains thanks to standards harmonization, better infrastructures, and simplification of rules of origin (Fergusson et al. 2013).

• Figure 3 | GDP growth in the US, EU and TPP countries (2007-2018, 2007=100 - forecasts)



Source: Chatham House elaboration on IMF data.

It is still too early to tell whether this trade deal would act as a challenger to the TTIP, or it would rather offer opportunities for complementarities and further multilateral economic liberalization. First of all, it is still unclear

27 They are Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, Vietnam. Japan joined the negotiations in Spring 2013.

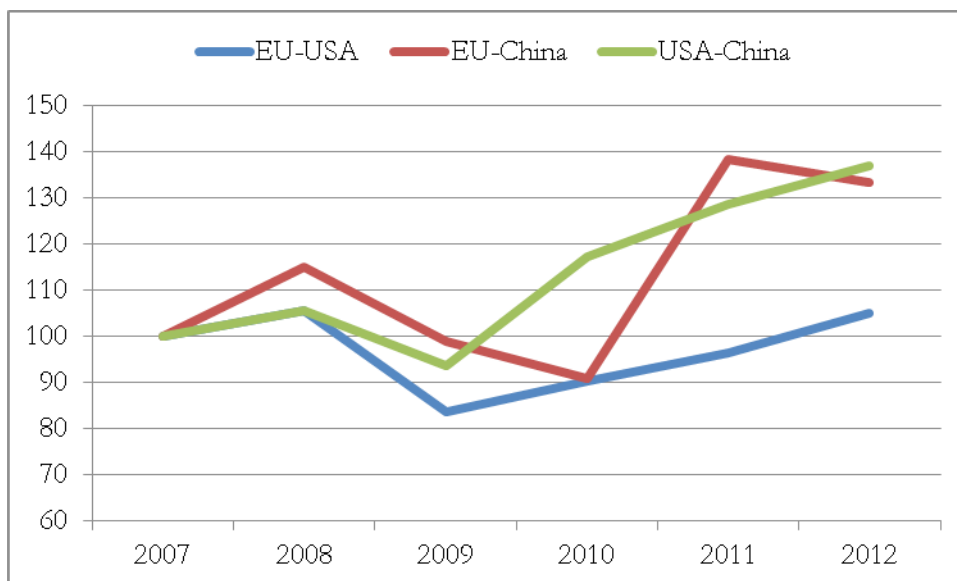
28 The US currently holds bilateral trade deals with Australia, Canada and Mexico (within the framework of the North-American Free Trade Area, NAFTA), Chile, Peru, Singapore.

when the negotiations will come to an end, given that the US Congress has not granted to the President the so-called “Fast Track Authority” (FTA), which would allow him to sign trade deals more easily.²⁹ Secondly, the inclusion of Japan (which is a highly protectionist country) in the negotiations might disclose even higher potential gains but also make remarkably more difficult to reach a final agreement (Posen 2014). Thirdly, many members of the TPP are small, developing countries, whose domestic markets cannot be compared to the EU, both in terms of size and sophistication. This is a reason why the partnership with the EU might remain more attractive from the US side, regardless the difficulties described in the previous paragraph.

5. ...and of China

The second global economy in terms of GDP and (probably very soon) the first in terms of traded merchandise, China is the main economic challenger to both free trade areas that could arise from successful results of the TTIP and the TPP negotiations, but it is going to be member of none. Economic interdependence with both the US and the EU, respectively, has been growing significantly. In terms of bilateral trade, both the EU and the US has increased their ties with China much more than between each other (Figure 4).³⁰

• Figure 4 | Bilateral trade between the EU, the US and China (2007=100, 2007-2012)



Source: Chatham House elaboration on data from UN Comtrade Statistics Database.

Due to growing commercial ties, each bilateral economic relationship has become increasingly complex. However, little coordination efforts have been recorded among the three economies at the multilateral level, mainly at the G20 level,³¹ and respective bilateral relations are still in their infancy and will take long time to

29 The fast track negotiating authority for trade agreements is granted to the President of the United States to the Congress in order to negotiate and sign directly trade deals with other countries. In January 2014 the Congress introduced a bill on “fast track authority” but Republican opposition has prevented the bill from being approved so far. Most likely, struggle in Congress between the two factions is expected to continue until the mid-term elections, to be held in November 2014.

30 Although the transatlantic relationship is still dominant in absolute terms (in 2012 total trade in goods amounted to 639 billion dollar), bilateral economic relations with China have increased a lot over the last six years: in 2012 EU-China and US-China trade relations amounted respectively to 557 and 554 billion dollar. See UN Comtrade Statistics Database: <http://comtrade.un.org/db>.

31 An example of collaboration is the 2012 Los Cabos summit, when China agreed to give 60 billion dollar assistance to the Eurozone.

become solid. The Strategic and Economic Dialogue (S&ED) between the US and China has often failed to achieve results on major issues: pressure for short-term deliverables at each summit has detracted from the dialogue's objective of fostering long-term strategic cooperation (Green et al. 2013). Within the framework of the EU-China 2020 Strategic Agenda for Cooperation, launched in November 2013, the EU started negotiations for an agreement on investment with China with the aim of increasing the level of bilateral investment, which is currently minuscule: just 2.1% of overall EU Foreign Direct Investment (FDI) is in China.³² The Investment Agreement will be mainly focused on easing the regulatory barriers which prevent bilateral FDI from growing further (European External Action Service 2013).

Within the growing net of regional and mega-regional trade negotiations (or super RTAs), China is the “elephant in the room” in both the TTIP and the TPP which, as we have seen, are likely to set the new rules and standard in global trade. In the words of the EU's trade commissioner Karel De Gucht, TTIP is indeed “about the weight of the Western, free world in world economic and political affairs” (Emmott 2013). TPP - even defined as “ABC - All But China”, is likely to change trade relations in South East Asia and have wider implications on the world economy. Developed economies have moved away from the multilateral trade system and “turned to super-RTAs” also because they are “intended to reinforce their global influence as international standard- and rule-setters” (Karmakar 2014:15). The TPP in particular is likely to question China's economic dominant role in the Pacific area, as the definition of common regulations and standards might favor a better integration of the economies involved in GVCs and induce discriminatory effects of investment diversion from China towards other economies members of the RTA (Karmakar 2014). Despite the mere economic consequences that China would suffer from, geopolitical considerations should be also taken into account. Were both the TTIP and TPP enforced, the new “geography” of global trade would probably put China in the corner and reduce its influence. It is still difficult at the moment to envisage how the country would react. However, in order to avoid frictions and episodes of economic retaliation, it would seem reasonable to foster the bilateral dialogues of China with both the EU and the US and make room for further cooperation and strategies able to deliver net gains.

Should the EU and the US not be able to involve China in a sort of “trialogue” aimed at achieving further economic cooperation (Tentori and Zandonini 2013), the Asian country might also take the opportunity to react actively in order to preserve its global preeminence as major trade actor (Hilpert 2014). A way for China to come out its traditional passive acceptance of global trade agreements (Karmakar 2014) would be to play a leadership role in the WTO using it as a “platform” to remain included in the network of trade liberalization (Petriccione 2014).

Conclusions

The US and the EU are still main actors in the global economy. However, over the last few years different policy responses were implemented because of different priorities, institutional frameworks, divergences intra-EU and intra-euro area (euro-ins vs. euro-outs, especially the UK, creditor vs. debtor countries).

Bilateral trade seems the area where the highest degree of convergence can be achieved. The TTIP deal could strengthen the relationship by boosting the two economies. There is a sort of “first mover advantage” the transatlantic partners can exploit if they achieve common rules in three fundamental sectors such as machinery and equipment, pharmaceutical products and agriculture. It is also possible to envisage positive externalities

³² This is mainly due to complicated regulations and public procurement rules which make it difficult for foreign companies to invest in China (European Commission 2014).

for the rest of the world, providing incentives for other countries to adapt to the new set of rules and accept the new standards if they want to continue to have access to the US and EU markets. It is still unclear whether this could lead to a new wave of multilateral economic liberalization, but we could expect a positive reaction from third countries rather than a return to protectionism.

However, there are non-negligible stumbling blocks and downside risks on the road towards a comprehensive and satisfactory agreement.

First of all, the EU's position is relatively weaker than the US's. It is struggling to recover sustained growth and it is affected by internal problems in terms of divergences between the eurozone and the so-called "euro-outs" (particularly with respect to the possibility of Britain leaving the EU in a not too distant future) and of a rising anti-EU sentiment. This could trigger centrifugal forces likely to weaken the strength of the EU as an integrated entity and diminish its relevance abroad. Moreover, its attractiveness as an economic partner for the US risks to be reduced in the future, as other regions are on the rise. The EU should increase its efforts on technological innovation as a driver to enhance productivity and growth, so as to remain an attractive partner to the US. A bigger effort would be required by the member States, in coordination with the EU institutions, in order to successfully implement the EU 2020 Agenda. Filling the "gap" with the US with respect to R&D would help the EU improve its growth potential and also continue attracting FDI from the US.

What emerges clearly is that the leadership of the US in trade negotiations is still unchallenged. The US is putting itself at the centre, not of a single global trade agreement, but rather of an ambitious network of mega-regional trade agreements with global reach through ambitious regional deals (Alden 2013). In particular, the Pacific area, with which the US is currently about to finalize negotiations for a Regional Trade Agreement (TPP), is becoming increasingly important for the US, not only in terms of trade and investment but also with respect to integration in GVCs, which offer room for complementarity in a region characterized by different economies in terms of resources and production structures. However, the Pacific region starts from a lower degree of economic integration with the US than the EU and it will not act as a huge challenger to the transatlantic relationship in the very short term.

Last but not least, China, the "elephant in the room" in the biggest trade negotiations, is the main actor to watch outside the transatlantic relationship, although it is not part of any trilateral relations nor any significant bilateral relations (EU-China, US-China) have been established so far. It is difficult at this stage to predict whether China will act as a challenger to the transatlantic relationship or it might be persuaded to comply with the new standards and regulations that will be enforced once the TTIP is put in place.

To conclude, given the current economic situation and the perspectives in the medium term, it seems the relationship will still remain an enduring partnership, but some downside risks suggest it might be heading along the continuum towards being more functional. The enforcement of the TTIP will be the "litmus test" for the relationship in order to assess whether a strategic partnership can be rebuilt and strengthened. However, at present the implementation of a fully-fledged TTIP in the very short-run is unlikely. Macroeconomic divergences between the two regions, as well as challenges to the EU coming from the Pacific area, are the biggest hurdles towards the strengthening of an enduring partnership.

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THE PROJECT

In an era of global flux, emerging powers and growing interconnectedness, transatlantic relations appear to have lost their bearings. As the international system fragments into different constellations of state and non-state powers across different policy domains, the US and the EU can no longer claim exclusive leadership in global governance. Traditional paradigms to understand the transatlantic relationship are thus wanting. A new approach is needed to pinpoint the direction transatlantic relations are taking. TRANSWORLD provides such an approach by a) ascertaining, differentiating among four policy domains (economic, security, environment, and human rights/democracy), whether transatlantic relations are drifting apart, adapting along an ad hoc cooperation-based pattern, or evolving into a different but resilient special partnership; b) assessing the role of a re-defined transatlantic relationship in the global governance architecture; c) providing tested policy recommendations on how the US and the EU could best cooperate to enhance the viability, effectiveness, and accountability of governance structures.

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